

*Washington State
Governor's Office and
Office of Financial Management*

**An Agency Guide to
Hosting a
Performance Audit:
Helpful Tips and Best Practices**

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STERLING
ASSOCIATES, LLP

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I. Introduction

In 2005, Washington’s citizens passed Initiative 900 (I-900) providing performance auditing authority and significant resources to the State Auditor’s Office (SAO) (see Appendix G). The intent of I-900 is to increase credibility of government services and to ensure government performance is monitored for effectiveness and efficiency. While performance audits have been conducted in Washington for over 30 years by the Joint Legislative Audit Review Committee (JLARC), I-900 significantly increases the scope, number and frequency of performance audits of state and local programs. Constructive and proactive engagement in the performance audit process by agencies will be necessary to fully achieve the vision set forth in I-900. This requires a clear understanding of the audit process, and guidance by the Governor’s Office and Office of Financial Management on responding to information requests, findings, and recommendations.

Some of the specific challenges the increased audit activity will bring to agencies include:

- Performance audits are new to many agencies.
- Performance audits are layered on top of other performance and management improvement activities underway in state government.
- While the initiative provided significant funding to the SAO to conduct performance audits of state services, funding was not provided to the agencies to prepare for the audits or respond to recommendations.
- The processes and protocols for conducting audits under I-900 are still developing, impacting agencies’ ability to prepare and respond appropriately to the first series of audits.
- Limitations in data access capabilities in current information systems may result in time consuming response processes.
- Limited staff resources are available to analyze and interpret available data.

For all of these reasons, it is prudent that agencies develop sound audit response processes and systems. Ill-prepared agencies will not be able to respond effectively to audit requests or make beneficial use of the results.

Under current statutes, performance audits may be conducted by the SAO or JLARC. Regardless of the entity conducting the audit, the process is fundamentally the same. This report provides an overview of the performance audit process with an explanation of each phase of the audit and helpful tips and best practices for agencies responding to auditors.

The best practices and tips documented in this report were gathered through interviews with agency staff who have recently been involved with a performance audit or review; interviews with JLARC and SAO management; and a review of the literature related to performance audit standards and practices, including the U.S. Government Accountability Office’s (GAO) Government Auditing Standards which are required to be followed under I-900.

Examples from the following four state experiences are used to highlight the lessons learned and best practices identified in the report:

- Health Care Authority, *Basic Health Plan Audit, Part 1*



- Department of Health, *Health Professions Licensing Review*
- Department of Licensing, *Transformation Performance Audit Board Performance Review*
- Office of Financial Management, *Year 2000 Risk Assessment Project*

Finally, several tools for state agencies are provided as appendices to this report. These include a checklist of suggested agency preparatory steps, a suggested issue management process, a data tracking tool, a resource tracking tool, and a confidentiality management process template.

What is a performance audit?

A performance audit is a tool that many public and private entities have come to use to make their work more efficient, effective and economical. In the process of a performance audit, evidence is assessed against objective criteria to determine opportunities for improvement. The SAO is required by I-900 to use the Generally Accepted Government Auditing Standards (GAGAS) (often called “the Yellow Book”) as its standards for conducting performance audits.

Performance audits have a broader focus on the organization’s effectiveness and efficiency than more traditional financial audits. Financial audits are conducted to provide an opinion about whether an entity’s financial statements are fairly presented and in conformity with generally accepted accounting principles. Financial audits do not focus on an entity’s performance *per se*, but rather whether it has taken appropriate actions to control and safeguard its finances and accurately report on its financial conditions.

What are the “Yellow Book Standards?”

The United States Government Accountability Office (GAO), an independent and non-partisan Congressional agency, published its first set of the Yellow Book standards in 1972, and has updated them several times since. Prompted by financial fraud scandals, and in response to concerns over audit practices and procedures, the standards provide broad guidelines for auditors’ responsibilities during financial and performance audits. The GAO describes a performance audit as follows:

2.09 Performance audits entail an objective and systematic examination of evidence to provide an independent assessment of the performance and management of a program against objective criteria as well as assessments that provide a prospective focus or that synthesize information on best practices or crosscutting issues. Performance audits provide information to improve program operations and facilitate decision making by parties with responsibility to oversee or initiate corrective action, and improve public accountability.¹

The current “exposure” edition of the Yellow Book is available on the GAO website at the following address: <http://www.gao.gov/govaud/ybk01.htm>. The revised performance audit standards outlined in the exposure draft are proposed to become effective on July 1, 2007.

¹ Government Auditing Standards, United States General Accounting Office, 2003 Revision.



Performance audits generally fall within two types:

- Economy and efficiency audits (e.g., adequate management control, appropriate staffing levels, properly protecting resources), and
- Program audits (e.g., achievement of program objectives and desired results, effectiveness of program or components).

According to the GAO standards, auditing provides a credibility mechanism for objective analysis of evidence to assess the condition of a program or entity. Among other things, Yellow Book standards require that evidence used in a performance audit must be “sufficient, competent and relevant.”² Further, these standards require that the audit organization and individual auditors be free from impairments to independence, be organizationally independent, and maintain independent attitude and appearance.

The basic premise of the Government Auditing Standards is that public officials and employees are responsible for:

- Efficient, economical, and effective use of resources;
- Complying with applicable laws and regulations;
- Establishing and maintaining effective controls; and
- Providing reports to those whom they are accountable.

How can a performance audit benefit an Agency?

Although an audit can be very challenging from an agency perspective, it does provide a number of benefits. Agency management is interested in doing work efficiently and effectively. Agencies can seize the opportunity to supplement their staff capacity for identifying management improvement opportunities and developing strategies for addressing them by participating in an audit. An auditor can often be an ally, even while maintaining their independence. And, recommendations offered by an auditor often carry additional weight in the policy arena and can sometimes support an agency’s request for needed policy changes or additional resources.

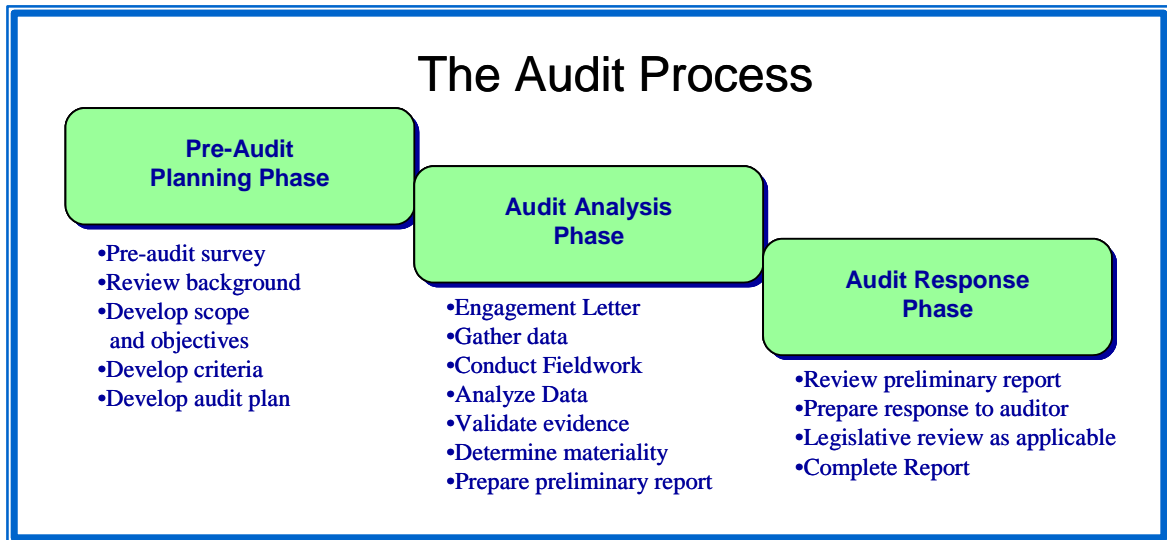
² Government Auditing Standards, United States General Accounting Office, 1994 Revision, p. 80.



II. The Audit Process

What is the standard performance audit process?

A typical performance audit is conducted in three phases: Pre-Audit Planning (sometimes referred to as “Scoping”), Audit Analysis and Audit Response. The following illustration, Exhibit I, highlights each of the phases and the major activities that occur during each phase.



*Sterling Associates, LLP 2006
Exhibit I*

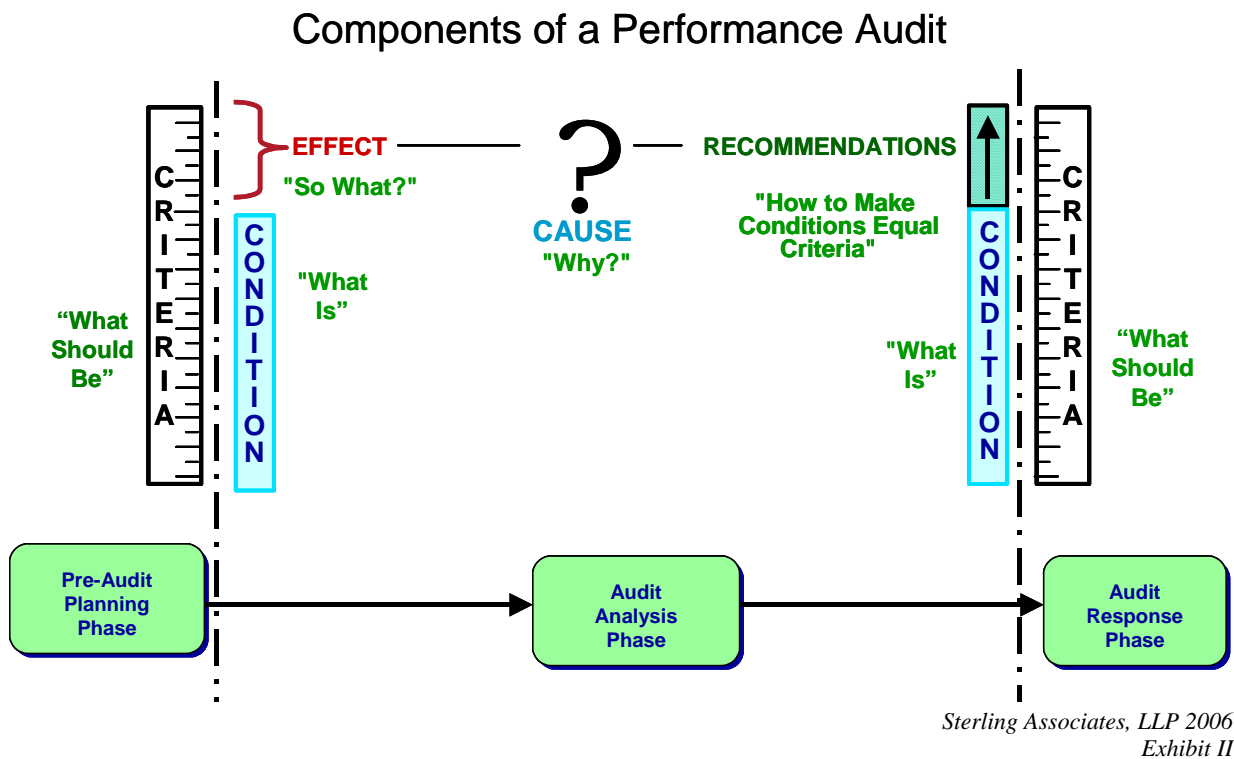
What are the components of a performance audit?

The performance audit should be designed to assess and measure program conditions against established objective criteria, as illustrated in Sterling Associates’ Exhibit II on the following page.

- The evaluation **criteria** (“what should be”) provide context for understanding the purpose of the program being audited. They describe what expectations have been set for the agency or program. Evaluation criteria can be drawn from:
 - Enabling statutes;
 - The agency’s mission statement;
 - Measurable goals and objectives developed pursuant to Washington State’s Budget and Accounting Act under RCW 43.88.090(2) and (3);
 - Washington Administrative Code;
 - Relevant federal laws and regulations;
 - Other budget and accounting requirements;
 - Policies and procedures;
 - Technically developed standards and norms;
 - Generally accepted benchmarks;
 - Performance of similar entities;
 - Government Auditing Standards;



- Performance in the private sector; and
 - Best practices of leading organizations.
- The current **conditions** (“what is”) are independently reviewed against the criteria by the auditor.
- **Exceptions** to the criteria are expressed in terms of effects (“so what”). In other words, if performance does not meet expectations, what is the impact and what is the significance of the shortfall? This is frequently referred to as the “materiality test.”
- The **causes** for the exceptions (“why”) are diagnosed and recommendations are prepared to bring conditions up to criteria. Under I-900, the SAO is required to develop step-by-step remedies to improving performance to the greatest extent possible.



Detailed explanations and tips, lessons learned and examples for each of these phases are included in the following pages.



III. The Pre-Audit Planning (“Scoping”) Phase

The pre-audit planning phase sets the foundation for the entire audit process. Typical activities completed in the pre-audit phase include:

- Confirming the scope and objectives of the audit
- Defining the audit criteria
- Developing the audit plan

What is the role of the auditor in the pre-audit planning phase?

At this stage the auditor notifies the agency of the planned audit. The purpose of this phase is to define the objectives, scope and methodology of the audit. Further, auditors prepare a methodology to conduct fieldwork. The purpose of the fieldwork is to collect sufficient, competent, and relevant “evidence.” Evidence is the quantitative and qualitative fact base that describes current conditions (“what is”). When determining the scope and objectives of the audit, the auditors develop an understanding of the program, its purpose and history and the reasons for initiating the audit. While the auditor is ultimately responsible for developing objective criteria against which they plan to measure performance, it is ideal if the agency is included in the criteria development process. The pre-audit planning phase also examines legal and regulatory requirements; program strategic plans, goals, resources, and outcomes; and prior audit findings and recommendations (audit follow-up). Sometimes an auditor will also conduct surveys of customers, employers, and stakeholders to identify potential audit focus areas.

One of the work products from this phase is the audit criteria to be used by the auditor. Another work product is a preliminary audit plan for conducting fieldwork to collect necessary evidence and the audit staff and contractor resources to perform the audit. It should be expected that the fieldwork plan might evolve as the audit proceeds and auditors gain more understanding of program data. The final deliverable from this phase is the approved scope and objectives for conducting the performance audit.

What is the role of the agency during the pre-audit planning phase?

Agency audit readiness activities should begin as soon as the auditor has identified the audit topic. This is the first opportunity for the agency to help set the tone of the audit and prepare for the upcoming activities. The agency should:

- Be open and positive about the audit. Consider the audit as an opportunity to look critically and constructively at a program. Establish an environment that will support a mutually trusting environment.
- Enable the auditor to be your advisor, while constantly understanding and respecting their independence.
- Respect the role of the auditor. They have a job to do and will do their best work when they are supported in their role. Their ability to identify management concerns, management improvement opportunities and ensure the accountability of public funds is important and necessary.



- Work with the auditor to understand the overall purpose of and approach to the audit.
- Understand how the audit was initiated (e.g., Auditor, Governor request, Legislature or Citizen Advisory Board) and what their assumptions and expectations are.

CASE IN POINT

Washington State Office of Financial Management, Year 2000 Risk Management Program

In 1997 the state implemented the Year 2000 Risk Management Program to prepare information technology systems and vital services to successfully cross the calendar year with no disruption in public services. The risk management approach was built upon the GAO performance auditing standards and was implemented on a statewide basis. A number of lessons were learned from this experience and are documented below.

- The Governor’s Office, the Office of Financial Management, the legislature and the cabinet were engaged from the outset and provided consistent management focus and leadership.
- Criteria for assessing systems and services were defined and agreed upon *up front*.
- Critical success factors were defined and had a risk management focus. The factors served as a basis for the risk assessment criteria and were applied *consistently* to all participating programs.
- On-going program and project management were *independently monitored and openly reported*, and practical recommendations for improvement were provided.
- Individual projects were managed by the business experts—dedicated agency staff.
- The openness and visibility of the process instilled confidence. Independent risk assessments provided credibility to the process and the findings.
- A clearly articulated communications strategy was developed and implemented. A public/private sector Advisory Board provided a valuable forum for information exchange and cooperation. In addition, information sharing with federal and local agencies enhanced cooperation and support.
- The reviews were conducted by nine independent consulting firms, all of which were trained in a common methodology and standards.

As with many audits, additional benefits were achieved:

- An inventory of the state’s vital services and mission critical information technology was established and helped eliminate some unnecessary IT applications.
- The state’s ability and infrastructure for responding to all kinds of emergencies was upgraded.
- Knowledge of the complex myriad of internal and external dependencies the state relies upon to deliver services was improved.
- The knowledge and ownership that business staff have over technical issues within their agencies was increased.
- Project management skills of many agency staff members were enhanced, and agency executives developed an increased level of understanding of these practices.
- An appreciation of independent performance auditing processes was developed.
- Formal and informal inter-agency networks for sharing information and best practices were developed.



What are key items that should be addressed during the pre-audit planning phase?

Before beginning the formal audit analysis phase, insist that the scope and objectives for the audit, as well as the evaluation criteria are clearly defined. Ensure that the criteria are bounded by law, the authorizing environment or generally accepted practices, such as benchmarks or formal performance measures.

- Let the auditor know that you expect to have a direct line of communication to them to ask and answer questions, clarify the audit process, scope and objectives, and criteria, and generally support the process as much as possible. Make sure that you understand the audit schedule, opportunities for providing input, and when information generated by the audit will become public.
 - When clarifications are made, document them and distribute them for comment. Ensure that both the agency and the auditor agree with the documented clarifications.
- The agency director should inform agency staff that an audit is underway. Identify in broad terms the nature of the audit and generally who the audit may directly affect (e.g., program, division, and managers).
 - Ensure the agency director is poised to represent the agency in the entrance interview and be available to provide support as needed in all ensuing audit processes, particularly in relation to resolution of critical agency issues that cannot be addressed at lower levels of an organization.
- Prepare a binder for the auditor to educate them about your areas of responsibilities, including: authorizing statutes, rules, regulations, budget provisos and strategic plans. The binder should also contain, if possible, agency initiatives affecting the subject area, relevant reports, and an overview of data availability. This advanced work will pay off substantially as the audit proceeds.
- Establish an audit response plan. The following key elements should be considered and implemented as appropriate.
 - Organize an audit response team. Name an audit liaison who has knowledge of the agency, program and data being requested by the auditor. For large audits that cross program boundaries, it may be necessary to set up an organizational structure that allows each program to identify contacts and assign responsibility for answering specific program-related questions.
 - Develop a resource monitoring process that can generally maintain a record of the staff resources required to respond and other costs related to responding to the audit. These can include copying fees, attorney fees, postage, or any other administrative costs. While these expenses cannot be transferred to the auditor, it will be helpful for future audits to understand the cost of responding to performance audits. (See Appendix B for a resource tracking template.)



- Clearly define the roles and responsibilities of all parties in the audit. I-900 authorizes the SAO to contract for performance auditing expertise. Audit teams may be a blend of state employed auditors and contracted consultants.
 - ✓ Ensure that the respective roles and responsibilities of the state audit staff and contracted consultants are clearly understood.
 - ✓ Clearly communicate to agency managers and staff that a mix of state auditors and private consultants will perform the audit.
 - ✓ If issues arise with the private consultants, address these through the issue management process.
 - Develop a strategy for communicating with agency staff, the media, the auditor and other stakeholders:
 - ✓ Clearly identify individuals who are responsible for communicating to the auditor or other parties.
 - ✓ Inform staff that all communications related to the audit must be reported to the audit liaison. Develop a process to document the nature of information requests to ensure that requests are satisfied. In most agencies, similar procedures exist for communicating with legislative staff and the media. These procedures may be a good starting point for developing internal audit response procedures. (See Appendix C for a data tracking template.)
- Ask to review the audit plan. If provided, review the timelines and determine internal resource requirements to support the audit plan. There may be situations where the audit is occurring during a critical program time or business cycle. If necessary, explain the circumstances to the auditor and discuss alternative processes or timeframes to minimize adverse program impacts.
- Agree with the auditor on an issue management process. The process should include steps for defining the issue and specific steps for resolving them at all levels of the organization. The agency and the auditor should formally agree to the issue management process at the outset of the audit.
- Use the issue management process when questions arise that the agency believes need to be resolved. These can include adherence to the Government Auditing Standards, competence of the assigned staff, or access to or concerns about evidence. The key is to elevate issues to the appropriate management level as soon as they are known and not wait until the report is delivered for a technical review. The best opportunity for addressing issues is before the auditor has formulated findings, conclusions and recommendations. (See Appendix D for an issue tracking template.)
- Define a process for managing confidential information. While the auditor will have open access to agency data, it will be necessary for all parties to protect personal and confidential data from unauthorized disclosure. When confidential data is involved, the



receiving party should follow accepted policies and procedures, including signing confidentiality agreements.

- The confidentiality process should address the control and custody of all data including: storage, access, work paper controls and redaction requirements.
- When questions arise, consult with agency legal counsel to clarify access and data custody issues.
- In some cases, there may be confidentiality issues with non-data requests such as private proprietary analytics and software. Ensure that there are sufficient agreements or licenses to allow appropriate access. (See Appendix E for a data confidentiality agreement template.)

CASE IN POINT

Washington State Department of Health, Health Professions Licensing Audit

One of the first official audits being conducted by the SAO under the Initiative 900 umbrella is just beginning at the Department of Health, in the Health Services Quality Assurance Division. The Division is responsible for regulating health professions by licensing, certifying and investigating concerns raised by citizens regarding care standards and professional conduct. Following a Government Management, Accountability, and Performance (GMAP) forum focusing on the Division's performance, Governor Gregoire asked the SAO to initiate and prioritize the audit to help the state respond to the concerns and further its goal of protecting the public. Although this audit is currently in the pre-audit planning phase, DOH has instituted a number of practices based on lessons learned from other agency audits.

- DOH has embraced the opportunity to have the SAO help them to identify concerns. They view the SAO auditors as consultants, while maintaining and supporting SAO's need for independence.
- DOH is gaining a clear understanding about the measures and criteria to be used in the audit.
- DOH has identified an agency liaison to work with the SAO and is setting up an internal structure to respond to the audit. Agency resources required to respond to the audit will be continually assessed; although, given other priorities and limited resources, this will remain a challenge throughout.
- DOH plans to highlight steps it has already taken to realign the investigative functions within the Division to better assess concerns once they have been raised. This effort has been underway for approximately six months and will help support them organizationally to respond in a more unified manner.



IV. Audit Analysis Phase

The audit analysis phase marks the beginning of the formal audit activities. Much of the agency work required during this phase will be driven by the scope and objectives and other agreements set forth in the pre-audit phase. Typical activities completed in the audit analysis phase include:

- Conducting the entrance conference
- Conducting fieldwork to gather evidence
- Managing the audit activities to the audit plan
- Analyzing data
- Validating evidence
- Determining materiality
- Diagnosing exceptions
- Preparing findings, conclusions and recommendations
- Drafting the preliminary report

What is the role of the auditor in the audit analysis phase?

During the audit analysis phase, the auditor begins the fieldwork activities. The first step is to send the agency an engagement letter and conduct an entrance conference. The engagement letter provides the agency its first official notice that an audit will be performed. The entrance conference denotes the first official meeting between the auditor and the auditee. At this meeting, the engagement letter is discussed in detail, with special attention focused on the scope and objectives of the audit.

Throughout this phase, the auditor is: (1) identifying documentation and data related to the scope and objectives, (2) preparing data collection instruments, (3) extracting data, (4) conducting interviews, and (5) tracking and monitoring progress.

At the conclusion of the fieldwork stage, the auditor evaluates conditions against the audit criteria, assesses materiality of any exceptions, diagnoses the reasons and prepares findings, conclusions and recommendations. The culmination of this phase is the draft audit report which is written independently by the auditor and presents the preliminary findings, conclusions and recommendations.

What is the role of the agency during the audit analysis phase?

Major agency activities during the fieldwork stage will focus on gathering documentation and other requested data and communicating status with the auditor. Based on the definition of the criteria defined within the scope and objectives, the agency will need to gather and transmit data that sufficiently documents the current condition of the program that is being assessed.

One of the first steps is to review the engagement letter and prepare questions related to the audit plan and scope. Use the audit liaison to funnel the questions to the auditor and develop a single response document. Ask the auditor to respond to the questions in writing. Ensure



the engagement letter addresses how requests will be made and agree upon how and when the agency will respond to formal requests.

At the entrance conference, include all managers who will be directly affected by the audit. This will include at a minimum the agency director, the program administrator, internal auditor, budget manager and the audit liaison.

Some suggestions for a productive entrance conference include:

- ✓ Commit to supporting the auditors and strike a constructive tone;
- ✓ Clearly designate the agency’s audit liaison and alternate, if needed;
- ✓ Resolve questions or concerns regarding the scope and objectives of the audit;
- ✓ Walk-through the audit plan, paying particular attention to data requirements;
- ✓ Openly discuss data availability constraints and discuss alternatives;
- ✓ Ensure that an issue management process is agreed upon;
- ✓ Request periodic status reports from the audit manager; and
- ✓ Agree upon a communications strategy.

During the analysis phase, the project conditions are evaluated with project evidence as illustrated in Exhibit III below. The project conditions include processes (*How, When, Who, and How Much*) and outcomes (*What*). The project evidence can include both tangible (physical) evidence and intangible (non-physical) evidence. While intangible evidence is important in evaluating satisfaction and acceptance, it is critical to balance this with as much tangible evidence as possible to ensure the findings and conclusions are supportable.

Sterling Associates, LLP 2006 Exhibit III

Performance Audit Evidence Grid

| | | Tangible | Intangible |
|----------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <div style="border: 1px solid black; padding: 5px; width: fit-content; margin: 0 auto;">Efficiency Measures</div> | Process (“How”) (“When”) (“Who”) (“How Much”) | <ul style="list-style-type: none"> Organizational charts Policies and Procedures Process flows Productivity indicators /activity costs Benchmark data | <ul style="list-style-type: none"> Testimonials Anecdotes Observation Constituent commentary |
| <div style="border: 1px solid black; padding: 5px; width: fit-content; margin: 0 auto;">Effectiveness Measures</div> | Outcomes (“What”) | <ul style="list-style-type: none"> Program performance data Cost per outcome Statistical reports Customer service level reports Comparative analyses | <ul style="list-style-type: none"> Stakeholder perceptions Customer / Client satisfaction and acceptance Client commentary |



The agency can take a number of steps to ensure the auditor has access to sound, tangible evidence.

- Take every opportunity to educate the auditor about your programs, services and the data you use to monitor performance. Help them understand the context, your constraints and how your situation is different from other agencies or states they may have audited.
- Work closely with the auditor throughout this stage and offer to provide a “technical review” of interim work products so that issues can be managed as they arise.
- The agency is responsible for ensuring it provides the auditor with reliable, repeatable evidence that would allow a “reasonable person” to draw the same conclusions.
- Identify known problems and the strategies that the agency is using to address the problems. Managers are usually aware of issues the agency is trying to resolve, so be candid with your challenges. Share your plans for addressing these challenges and ask the auditors for their opinions and suggestions.
- Implement your own internal controls on the data you provide to the auditor. Make sure your liaison has access to the most accurate and reliable version of the data. Ensure that staff throughout the agency are not duplicating data collection efforts, which increases the risk that inaccurate data will be delivered to the auditor.
- Identify the staff within the agency who best understand the data. Allow them to identify the most appropriate sources and locations of records and data. Assign agency data experts the responsibility for responding to data requests.
- Clarify all data requests:
 - Determine what type of data is needed.
 - ✓ The audit liaison should identify any concerns (e.g., availability, onerous demands, timeliness, etc.) related to data collection to the auditor immediately. If the concern is not addressed, escalate the issue through the issue management process.
 - Agree on the media needed (e.g., electronic or hard copy).
 - Agree on the timeline for delivering data.
 - ✓ If the timeline is not reasonable, escalate the issue through the issue management process until agreement can be reached. The agency should clearly define why data might take longer than anticipated to gather.
 - Document all agreements on data requests.
 - Above all, **respond to all data requests in a timely manner.**
- In providing evidence for the audit, agencies should keep the following questions in mind: Is the data used appropriate for the audit? Does it cover the same period the audit did? Was it corroborated? Is the data collection process repeatable? Is it reasonable?



Would an independent third party draw the same conclusion? Is it traceable to the data sources?

- If the agency determines that the provided evidence is inaccurate, the agency director should notify the auditor immediately that an error has occurred and that new or revised data is available. The corrected data and evidence should be delivered immediately once the error has been discovered.
- If the agency data is too late to be considered in the analysis phase of the audit, it should be identified in the agency response to the audit findings.

CASE IN POINT

Washington State Health Care Authority, Basic Health Plan Audit

In 2006, the Joint Legislative Audit and Review Committee (JLARC) conducted the first part of a two-part performance audit of the state's Basic Health Plan (BHP), which provides health insurance coverage to low-income residents in Washington State. Part 1 of the study examined the extent to which the BHP's policies and procedures promote or discourage the provision of appropriate, high-quality, cost-effective care for enrollees of the plan.

A number of challenges were addressed in this audit. Data required by the auditors contained confidential information regarding citizens' health insurance status. Questions arose around releasing data to the auditor, slowing down the audit process and leading to frustration. Though the auditor has broad legal authority (subpoena power) to access data and is bound to keep it confidential (RCW 44.28.097, RCW 44.28.110, RCW 43.09.165), HCA also has a legal obligation to protect confidentiality. There were three critical lessons learned from this issue.

- Agree on a process for managing confidential data in the pre-audit planning phase of the audit. Make sure to address access to and storage of the data. If necessary, engage agency legal counsel early when questions regarding laws and regulations that could affect the audit process. Legal counsel for HCA and JLARC only met after the audit had already started, unnecessarily impacting the audit schedule and leading to stress between the auditors and the agency.
- Agree on an issue management process to elevate decisions that cannot be easily resolved to higher management levels.
- Clearly document data needs, expectations, and limitations early in the process to ensure the auditors receive the best possible data, and that the agency has a clear understanding of the requested data, and the required timelines and formats.

HCA also faced challenges regarding the scope and objectives of the study. There was not always agreement on what the scope and objectives really meant. HCA learned that understandings reached during the audit process should be documented so that when previously answered questions arose, there was a written record of the decisions. Changes in audit personnel



also required the agency to renegotiate or clarify issues that had been decided previously. Documented agreements would have decreased the amount of rework required.

HCA staff offered these final “lessons learned”:

- Ensure the audit plan is clearly defined with timelines, roles and responsibilities, and clear definitions and expectations.
- Educate internal staff on the appropriate process for responding to audit concerns. Ensure that staff are informed about who and what can be released to the auditor.
- Identify the internal staff who are in the best position to answer the question and then use them.
- Know your data – make sure that staff know what data exists and where it is located *before* the audit begins.
- Be careful to clearly communicate the relevance (“materiality”) of audit findings and recommendations. Put the findings in perspective from a citizen’s viewpoint.
- Go into an audit with confidence and be open about the recommendations and how they might improve your operations.



V. Audit Response Phase

The audit response phase is the final formal stage of a performance audit. Major activities include:

- Delivery of the preliminary report;
- Reviewing the preliminary report;
- Preparing the agency’s formal response to the audit;
- Attending the exit conference; and
- Finalizing the audit and publishing the results.

What is the role of the auditor in the audit response phase?

The attention of the auditor during the audit response phase is focused on completing the preliminary report and preparing for the exit conference. The auditor will assess how well the agency is performing against its measures and assess the degree to which recommendations are needed to improve effectiveness and efficiency. I-900 requires the auditor to provide “step-by-step” remedies that will correct any identified deficiencies. The purpose of “step-by-step” remedies is to ensure agencies are provided with “doable” recommendations that can be implemented within their ability, or that clearly identify where actions by others may be necessary (e.g., legislation).

During the audit response phase, interactions with the agency may initially be limited to clarification of data or questions regarding specific evidence. This final “technical review” is often critical to the integrity of the audit report, and should be insisted upon by the agency. After the agency has responded to the audit report, the auditor may amend the report or finalize it as is. The reports are generally published at this stage and available to the public.

- One key role of the auditor is to prepare report disclosures. Disclosures are outlined in the GAO Government Auditing Standards and should be included in the preliminary report. At a high level the disclosure statements should address as applicable:
 - Compliance with Government Auditing Standards. If an audit standard was not met, the fact should be noted including the reason why and the effect on the audit;
 - Auditor impairments to independence; and
 - Data validity.

What is the role of the agency during the audit response phase?

Agencies should identify staff required to review the report and ensure they are available to respond once it is delivered. While the audit response process is underway, the agency should begin, if it hasn’t already, working on audit recommendations with which the agency agrees. This type of proactive and constructive response is encouraged and can make a big difference in how the audit is received by the Governor’s Office, OFM, the Legislature, and the public. It is important that agency audit responses clearly describe steps taken by the agency to address the audit findings and recommendations. In addition, it is also important that agency



managers and staff fully understand the agency's position on audit findings and recommendations, and communicate this position clearly and consistently.

- Upon receipt of the preliminary report, the agency should review the report, paying careful attention to answering the following questions:
 - Are there factual or material errors in the evidence supporting the findings?
 - Was there any evidence omitted from the report?
(Hopefully, any issues will have been taken care of in earlier technical reviews.)
- It is critical that agencies document their responses in a very fact-based approach. It is always best to keep emotions out of the process as they often cloud the issues and may decrease the credibility of the response.
 - The preliminary report should be considered a draft document. It is important that the auditor and the agency maintain the report in confidence until the questions can be addressed. Releasing the preliminary report in advance of completing this process could affect the credibility of the report or of the parties responsible for addressing the concerns.
- Ask to see the workpapers used to assess performance. In some cases the evidence may not be available until the audit is published. However, the evidence supporting the findings should be shared freely by the auditor, and in any case is open to public record disclosure pursuant to adopted policies and procedures.
- Any formal written response should be consolidated from the multiple reviewers and should come only from the agency director. It is appropriate and encouraged to ask for input from the Governor's Office and OFM during this part of the process. Other tips to include in the response letter include:
 - When possible, highlight what you are already doing to resolve the issues.
 - Be willing to commit to making other changes in the future. Use the audit recommendations to your benefit.
 - Follow-up on recommendations. An agency can benefit by taking the lead where appropriate.



. CASE IN POINT

Washington State Department of Licensing, Performance Review

In 2004, the Department of Licensing underwent a review of transportation-funded programs by the Transportation Performance Audit Board (TPAB), a transportation-related board affiliated with the JLARC. The review has been touted as a very successful experience for both the agency and TPAB. The agency believes the experience was valuable for a number of reasons.

- The review was not a formal “audit”, but a *review*. Agency staff believe this difference in scope helped establish a collaborative process rather than a regulatory one.
- DOL staff welcomed the “consultants” and looked forward to working with them to improve services.
- An organizational structure for the review was defined at the beginning. A liaison was named, and because the review would require staff from multiple divisions within the department, staff from each division were named as contacts for the liaison.
 - DOL stated that approximately 40 staff were involved during the review process.
- Resources were tracked in terms of hours and other costs, such as duplicating records and responding to requests. DOL has a better idea about the number of staff and the amount of other resources it will need for future audits.
- All contacts with the consultants and data requests were funneled through the liaison. Contacts with the consultant were logged and reported so that the liaison could manage the communication and data flows effectively.
- DOL was able to highlight areas they were already working to improve, and the consultant gave the agency credit in the final report for the efforts it was making to improve its efficiency and effectiveness.

Conclusion

This document is intended to provide insight into the performance auditing process and to help agencies prepare for future audits. These audits may present challenges, both in terms of marshalling the necessary staff and data resources to respond appropriately to an auditor’s needs, and in raising and addressing issues regarding an agency’s performance. However, if an agency is well positioned to support the audit, it can be a positive and productive undertaking, resulting in sound recommendations for improving government performance.



Appendix A - Checklist for Agency Performance Audit Participation

Pre-Audit Planning Phase

- Establish Audit Response Plan
- Name the audit liaison
- Organize an audit response team
- Begin to document data location and availability
- Assign staff to data needs and data tracking
- Develop a resource monitoring process
- Develop an internal and external communication strategy
- Understand the audit schedule, opportunities for input and technical review, and when information will become public
- Prepare background information for the auditor
- Review the Auditor's audit plan
- Agree on an issue management and escalation process
- Ensure that the respective roles and responsibilities of the state audit staff and any contracted consultants are clearly understood
- Agree on a confidentiality data management plan, if necessary

Audit Analysis Phase

- Review the engagement letter and respond with questions as necessary
- Participate in the entrance conference including agency staff responsible for responding to the audit requests
- Implement controls established in the previous phase
- Notify all staff that the audit is underway and communicate internal protocols
- If contracted consultants are involved in the audit, clearly communicate to agency managers and staff that a mix of state auditors and private consultants will perform the audit
- Identify staff most knowledgeable about agency data
- Clarify all data requests (data required, timelines, data period, etc.) and document the agreements
- Respond to data requests in a timely fashion
- Ensure that all data provided is accurate, reliable and complete, and includes data definitions, protocols, etc.
- If issues arise with the private consultants involved in the audit, address these through the issue management process



- Ask for opportunities to conduct “technical review” of auditor work and analysis where appropriate

Audit Response Phase

- Review draft audit report for accuracy and completeness
- Ask clarifying questions of the auditor as soon as possible after receipt of the report
- Provide additional clarifying information to the auditor
- Begin work immediately on agreed upon audit recommendations, and share progress in the agency’s response
- Develop one, centrally managed response
- Consult with the Governor’s Office and OFM where necessary
- Keep the tone of the response positive and constructive



Appendix B – Resources Tracking Template

The Resources Tracking Template is used to track staff and other incidental costs incurred as a result of responding to a performance audit.

- The template contains a number of sheets that would need to be customized for the agency and audit being performed.
- Employees would enter their hours in a shared file on a periodic basis as prescribed by the agency.
- Rates for each employee are captured on a sheet and used to calculate hourly rates by employee.
- Rates are multiplied by the number of hours worked to calculate staff costs.
- Other costs such as Attorney General changes or duplication costs are tracked on the summary sheet.

| Employee Input Sheet | | | |
|--------------------------------|--------------|-------------|------------------------------------------------|
| Jul-06 | <u>Hours</u> | <u>Cost</u> | <u>Justification</u> |
| Program 1 | | | |
| Enter Employee Name 1 | 2.0 | \$ 72.92 | Internal meetings; correspondance with auditor |
| Enter Employee Name 2 | | \$ - | |
| Enter Employee Name 3 | 4.0 | \$ 165.17 | Reviewed auditor docs |
| Sub-Total, Program 1: | 6.0 | \$ 238.09 | |
| Program 2 | | | |
| Enter Employee Name 1 | 4.0 | \$ 164.27 | meeting with auditor |
| Enter Employee Name 2 | | | |
| Enter Employee Name 3 | | | |
| Sub-Total, Program 2: | 4.0 | \$ 164.27 | |
| Agency Total, this time | | | |

| TOTAL - ALL TIME PERIODS | | | |
|-------------------------------------------------|--------------|-------------|--|
| | <u>Hours</u> | <u>Cost</u> | |
| Enter Program - Division Name from tab 1 | | | |
| Employee Name 1 | 2.0 | \$ 72.92 | |
| Employee Name 2 | - | \$ - | |
| Employee Name 3 | 4.0 | \$ 165.17 | |
| Sub-Total, Program 1 | 6.0 | \$ 238.09 | |
| Enter Program - Division Name from tab 1 | | | |
| Employee Name 1 | 4.0 | \$ 164.27 | |
| Employee Name 2 | 8.0 | \$ 364.58 | |
| Employee Name 3 | - | \$ - | |
| Sub-Total, Program 2: | 12.0 | \$ 528.85 | |
| Additional Costs | | | |
| Attorney Fees (AGO costs) | | \$ 700.00 | |
| Duplication/Printing Costs | | \$ 450.00 | |
| Sub-Total | | \$ 1,150.00 | |
| Agency Total: | 36.0 | \$ 2,683.88 | |

Summary Sheet



Appendix C – Data Tracking Template

The Data Tracking Template is used to document data requests, control versions of data provided to the auditor and track whether requests are timely.

- The agency will need to assign responsibility for managing data requests from the auditor (generally this would be the responsibility of the audit liaison).
- The assigned party is responsible for receiving all data requests, logging them into the tracking log, assigning them to appropriate agency data experts, gathering the documentation and delivering requested documentation to the auditor within the defined timelines.

| Tracking # | Data requested | Version Supplied | Assigned to | Date Required | Date Delivered | Status/Comments |
|------------|----------------|------------------|-------------|---------------|----------------|-----------------|
| 1 | | | | | | |
| 2 | | | | | | |
| 3 | | | | | | |
| 4 | | | | | | |
| 5 | | | | | | |
| 6 | | | | | | |



Appendix D – Issue Management Template

The Issue Management Template provides a tracking mechanism for issues and their resolution.

- The agency will need to assign responsibility for managing the issue process (generally this would be the responsibility of the audit liaison).
- The assigned party is responsible for identifying, assigning for resolution, monitoring for completion and closing issues. Status for each issue should be clearly identified, including: decisions made, open issues or action items. A simple tracking log such as the one shown below can help organize and document issues, reducing the number of times issues resurface or must be re-negotiated.
- The issue management process assumes an escalation process has been defined.
 - Generally, issues should be resolved at the lowest level possible in the organization. If resolution cannot be achieved at this level, the audit liaison is responsible for escalating the issue to the next level of authority. Ultimately, some issues may need to be resolved at the Agency Director / State Auditor or Legislative Auditor level; this should be on an exception basis only.
- Some issues may require the preparation of formal issue papers to describe and document the issue, alternatives explored, impact analyses (e.g., costs for responding to the audit, staff time and effort impacts), and recommendations.

| Action # | Issue/Action Item | Responsible | Decision-Maker | Assigned Date | Date Due | Status |
|----------|-------------------|-------------|----------------|---------------|----------|--------|
| 1 | | | | | | |
| 2 | | | | | | |
| 3 | | | | | | |
| 4 | | | | | | |
| 5 | | | | | | |
| 6 | | | | | | |



Appendix E – Data Confidentiality Agreement Template

NOTE: The following template is provided to illustrate the types of confidentiality issues the agency and the auditor should consider prior to the start of an audit. Actual agreement between the parties should be prepared in coordination with the agency and auditor’s legal counsel.

SAMPLE DATA CONFIDENTIALITY AGREEMENT

Between:

[ENTER AGENCY NAME] (“Agency”)

and

[ENTER AUDIT ENTITY NAME] (“Auditor”)

In anticipation of an audit regarding the [ENTER DEPARTMENT, DIVISION AND/OR PROGRAM BEING AUDITED] the parties agree to the following Data Confidentiality Agreement (“Agreement”).

1. On the consideration that both parties are interested in a collaborative audit process, it is agreed that all confidential information provided to the Auditor required to assess agency effectiveness and efficiency, be kept confidential as required by state regulations [ENTER APPROPRIATE CITATION].
2. This agreement covers the following data: [ENTER THE SPECIFIC DATA THAT IS SUBJECT TO CONFIDENTIALITY (E.G., CLIENT NAMES, EMPLOYEE HEALTH PLAN INFORMATION ETC.)]
3. The Auditor agrees to not use the information for any purpose, other than for the purpose of conducting the audit.
4. The Auditor agrees to inform all parties with access to the confidential data of the confidentiality agreement and to require all parties to sign individual confidentiality agreements prior to accessing the data.
5. The Agency agrees to disclose requested confidential data to the Auditor upon finalization of the Agreement. The Agency understands that failure to disclose data in a timely manner may compel the Auditor to obtain a subpoena for accessing the requested data.
6. Access to confidential data will be limited to [ENTER INDIVIDUALS WHO WILL HAVE ACCESS TO THE DATA IN QUESTION].



7. The Auditor shall maintain a record of entities or persons who have accessed the Confidential Information including the actual information disclosed to them, the date and reason for access.
8. The information requested [IS/IS NOT] subject to additional license/proprietary restrictions. [IF YES, ENTER SPECIFIC LICENSE RESTRICTIONS (E.G., SOFTWARE LIMITATIONS, ABILITY TO USE PROPRIETARY TOOLS)].
9. Confidential data will be kept in a secure location at the [ENTER LOCATION (E.G., STATE AUDITOR'S OFFICE, AGENCY, ETC.)]. The Auditor shall take all reasonable measures to maintain security of the data during and after the audit has been complete.
10. The Auditor shall notify the agency promptly upon becoming aware of any unauthorized disclosure, copying, use or loss of all or any part of the confidential data.

The parties certify that they will abide by the agreement set forth above.

Signature

Signature

Printed/Typed Name

Printed/Typed Name

Date

Date



Appendix F – Glossary of Performance Audit Terms

Government Accountability Office (GAO)

The U.S. Government Accountability Office (GAO) (formerly General Accounting Office) is an independent, nonpartisan agency of Congress. The GAO establishes Government Auditing Standards and ensures that government is accountable to the American people by evaluating how well government policies and programs are working; auditing agency operations to determine whether federal funds are being spent efficiently, effectively, and appropriately; investigating allegations of illegal and improper activities; and issuing legal decisions and opinions.

Entrance Conference

The entrance conference denotes the first official meeting between the auditor and the auditee. At this meeting, the engagement letter is discussed in detail, with special attention focused on the scope and objectives of the audit and how the audit will be managed and conducted, including the management of issues that may arise during the audit.

Economy and efficiency audits

Economy and efficiency audits means performance audits that establish: (a) Whether a state agency or unit of local government receiving state funds is acquiring, protecting, and using its resources such as personnel, property, and space economically and efficiently; (b) the causes of inefficiencies or uneconomical practices; and (c) whether the state agency or local government has complied with significant laws and rules in acquiring, protecting, and using its resources.

Evidence

Audit evidence comprises the qualitative and quantitative facts that are used to assess program conditions. The evidence serves as the foundation upon which audit findings are built. Audit evidence can be categorized as “tangible” or “intangible” about program processes (efficiency measures) and program results (effectiveness measures). Please see Exhibit III for examples.

Exit Conference

The purpose of the exit conference is to: (1) share the auditor’s findings, conclusions and recommendations; (2) present the agency’s concurrence, partial concurrence and non-concurrence with the audit findings, conclusions and recommendations; (3) outline “step-by-step” implementation requirements; and (4) discuss other improvement suggestions that may not have risen to a formal recommendation.

Final Report

The final report is the final document adopted by the auditor and contains their findings, conclusions and final recommendations. It also includes the agency’s concurrence, partial concurrence and non-concurrence with the final recommendations made by the auditor, and the agency’s supporting rationale for its position.



JLARC

The Joint Legislative Audit & Review Committee (JLARC) is a joint (bicameral), bi-partisan committee comprised of 16 legislators. JLARC has been conducting performance audits, program evaluations, sunset reviews, and other studies for the Legislature since 1973 [Prior to 1996, JLARC was known as LBC (Legislative Budget Committee)].

Legislative Auditor

The Legislative Auditor is the executive officer of the Joint Legislative Audit and Review committee.

Materiality

Materiality is a judgment test of the pervasiveness or severity of the impacts of an audit exception. It is used to assess the adverse effects of a difference between established criteria and program conditions.

Performance Audit

A performance audit is an objective and systematic assessment of an organization or any of its programs, functions, or activities by an independent and qualified evaluator in order to help public officials improve efficiency, effectiveness, and accountability. Performance audits include economy and efficiency audits and program effectiveness audits.

Performance Measures

Performance measures are a composite of key indicators of a program's or activity's inputs, outputs, outcomes, productivity, timeliness, and/or quality. They are means of evaluating policies and programs by measuring results against agreed upon program goals or standards.

Preliminary Report

The preliminary performance audit report is a written document prepared for review and comment after the completion of a performance audit. The preliminary performance audit report contains the audit findings, conclusions and any proposed recommendations to improve the efficiency, effectiveness, or accountability of a state or local government agency or program.

State Auditor's Office (SAO)

The State Auditor is a separately elected official in Washington State responsible for conducting financial and performance audits of state and local government entities.

Scope and Objectives

The scope and objectives form the foundation of an audit by setting the parameters around what will be evaluated. The scope and objectives is one of the first work products produced by the auditor in the audit-planning (Scoping) phase.



Technical Review

The technical review is requested by the agency prior to the official preliminary report being produced. The purpose of the technical review is to allow the agency to preview draft audit findings, supporting evidence and analysis to assist the auditor with their quality control over the audit. This is performed to ensure the credibility of the audit.

Yellow Book Standards

The Yellow Book standards refer to the Government Auditing Standards published by the U.S. Government Accountability Office. As referenced in the following Appendix G, I-900 requires the State Auditor's Office to conduct performance audits in compliance with these generally accepted standards.



Appendix G – Initiative 900 – Section 2

The following is an excerpt from Initiative 900 that relates to the State Auditor's Office authority and responsibilities for conducting performance audits:

Section 2: Requiring Independent, Comprehensive Performance Audits Of State And Local Governments, Agencies, Programs, And Accounts

In addition to audits authorized under RCW 43.88.160, the state auditor shall conduct independent, comprehensive performance audits of state government and each of its agencies, accounts, and programs; local governments and each of their agencies, accounts, and programs; state and local education governmental entities and each of their agencies, accounts, and programs; state and local transportation governmental entities and each of their agencies, accounts, and programs; and other governmental entities, agencies, accounts, and programs. The term "government" means an agency, department, office, officer, board, commission, bureau, division, institution, or institution of higher education. This includes individual agencies and programs, as well as those programs and activities that cross agency lines. "Government" includes all elective and non-elective offices in the executive branch and includes the judicial and legislative branches. The state auditor shall review and analyze the economy, efficiency, and effectiveness of the policies, management, fiscal affairs, and operations of state and local governments, agencies, programs, and accounts. These performance audits shall be conducted in accordance with the United States general accounting office government auditing standards. The scope for each performance audit shall not be limited and shall include nine specific elements: (1) identification of cost savings; (2) identification of services that can be reduced or eliminated; (3) identification of programs or services that can be transferred to the private sector; (4) analysis of gaps or overlaps in programs or services and recommendations to correct gaps or overlaps; (5) feasibility of pooling information technology systems within the department; (6) analysis of the roles and functions of the department, and recommendations to change or eliminate departmental roles or functions; (7) recommendations for statutory or regulatory changes that may be necessary for the department to properly carry out its functions; (8) analysis of departmental performance data, performance measures, and self-assessment systems; and (9) identification of best practices. The state auditor may contract out any performance audits. For counties and cities, the audit may be conducted as part of audits otherwise required by state law. Each audit report shall be submitted to the corresponding legislative body or legislative bodies and made available to the public on or before thirty days after the completion of each audit or each follow-up audit. On or before thirty days after the performance audit is made public, the corresponding legislative body or legislative bodies shall hold at least one public hearing to consider the findings of the audit and shall receive comments from the public. The state auditor is authorized to issue subpoenas to governmental entities for required documents, memos, and budgets to conduct the performance audits. The state auditor may, at any time, conduct a performance audit to determine not only the efficiency, but also the effectiveness, of any government agency, account, or program. No legislative body, officeholder, or employee may impede or restrict the authority or the actions of the state auditor to conduct independent, comprehensive performance audits.



To the greatest extent possible, the state auditor shall instruct and advise the appropriate governmental body on a step-by-step remedy to whatever ineffectiveness and inefficiency is discovered in the audited entity. For performance audits of state government and its agencies, programs, and accounts, the legislature must consider the state auditor reports in connection with the legislative appropriations process. An annual report will be submitted by the joint legislative audit and review committee by July 1st of each year detailing the status of the legislative implementation of the state auditor's recommendations. Justification must be provided for recommendations not implemented. Details of other corrective action must be provided as well. For performance audits of local governments and their agencies, programs, and accounts, the corresponding legislative body must consider the state auditor reports in connection with its spending practices. An annual report will be submitted by the legislative body by July 1st of each year detailing the status of the legislative implementation of the state auditor's recommendations. Justification must be provided for recommendations not implemented. Details of other corrective action must be provided as well. The people encourage the state auditor to aggressively pursue the largest, costliest governmental entities first but to pursue all governmental entities in due course. Follow-up performance audits on any state and local government, agency, account, and program may be conducted when determined necessary by the state auditor. Revenues from the Performance Audits of Government Account, created in section 5 of this act, shall be used for the cost of the audits.



Appendix H – RCW 44.28.017, Authorizing the Joint Legislative Audit and Review Committee to conduct performance audits

The following is an excerpt from RCW 44.28.017 that relates to JLARC’s authority and responsibilities for conducting performance audits.

RCW 44.28.071

Conduct of performance audits

- (1) In conducting performance audits and other reviews, the legislative auditor shall work closely with the chairs and staff of standing committees of the senate and house of representatives, and may work in consultation with the state auditor and the director of financial management.
- (2) The legislative auditor may contract with and consult with public and private independent professional and technical experts as necessary in conducting the performance audits. The legislative auditor should also involve front-line employees and internal auditors in the performance audit process to the highest possible degree.
- (3) The legislative auditor shall work with the legislative evaluation and accountability program committee and the office of financial management to develop information system capabilities necessary for the performance audit requirements of this chapter.
- (4) The legislative auditor shall work with the legislative office of performance review and the office of financial management to facilitate the implementation of effective performance measures throughout state government. In agencies and programs where effective systems for performance measurement exist, the measurements incorporated into those systems should be a basis for performance audits conducted under this chapter.

