

# HOUSE BILL REPORT

## HB 2148

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**As Reported by House Committee On:**  
General Government & Information Technology

**Title:** An act relating to the state auditor including allowing for audits to be conducted by a private entity and establishing an appeal process.

**Brief Description:** Concerning the state auditor including allowing for audits to be conducted by a private entity and establishing an appeal process.

**Sponsors:** Representatives Chandler, Pike and Hudgins.

**Brief History:**

**Committee Activity:**

General Government & Information Technology: 2/23/15, 2/8/16 [DPS].

**Brief Summary of Substitute Bill**

- Authorizes local governments to request a private financial audit, in lieu of one by the State Auditor.
- Allows state agencies or local governments to appeal the results of any audit pursuant to the Administrative Procedure Act.
- Prohibits audit reports to be made public until the appeal process is complete.
- Requires the State Auditor to adopt rules requiring the presiding officer of the appeal to be an administrative law judge assigned by the Office of Administrative Hearings.

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**HOUSE COMMITTEE ON GENERAL GOVERNMENT & INFORMATION TECHNOLOGY**

**Majority Report:** The substitute bill be substituted therefor and the substitute bill do pass. Signed by 6 members: Representatives Hudgins, Chair; Kuderer, Vice Chair; MacEwen, Ranking Minority Member; Caldier, Assistant Ranking Minority Member; Johnson and Morris.

**Minority Report:** Without recommendation. Signed by 1 member: Representative Senn.

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*This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.*

**Staff:** Lily Sobolik (786-7157).

**Background:**

*State Auditor's Office.*

The State Auditor's Office (SAO) holds state and local governments accountable for the use of public resources. By constitution, the State Auditor has the power to examine the financial affairs of all governments in the state, including local governments, schools, all state agencies, and institutions of higher education. In addition, the SAO carries out special investigations and performance audits of state and local governments.

*Administrative Procedure Act.*

Washington's Administrative Procedure Act (APA) establishes procedures under which state agencies adopt rules and conduct adjudicative proceedings. Generally, a rule is any agency order, directive, or regulation of general applicability which: (1) subjects a person to a sanction if violated; or (2) establishes or changes any procedure or qualification relating to agency hearings, benefits or privileges conferred by law, licenses to pursue any commercial activity, trade, or profession, or standards for the sale or distribution of products or materials. An agency may not adopt rules absent a grant of authority by the Legislature. A person or business adversely affected by an agency action may ask the agency for an adjudicative hearing.

*Office of Administrative Hearings.*

The Office of Administrative Hearings (OAH) is an independent state agency responsible for the review of state agency, and some local government decisions. Hearings before the OAH are presided over by an administrative law judge (judge) appointed to conduct such hearings. The hearings are conducted in accordance with statutory procedures outlined in the APA and are generally less formal than court proceedings.

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**Summary of Substitute Bill:**

The substitute bill authorizes local governments to request a private financial audit, in lieu of one by the State Auditor. The substitute bill allows state agencies or local governments to appeal the results of any audit pursuant to the APA and prohibits audit reports from being made public until the appeal process is complete. The substitute bill requires the State Auditor to adopt rules requiring the presiding officer of the appeal to be an administrative law judge assigned by the OAH.

**Substitute Bill Compared to Original Bill:**

The original bill required the SAO to approve the request of local governments requesting a private financial audit; the substitute bill removes this requirement.

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**Appropriation:** None.

**Fiscal Note:** Requested on February 9, 2016.

**Effective Date of Substitute Bill:** The bill takes effect 90 days after adjournment of the session in which the bill is passed. However, the bill is null and void unless funded in the budget.

**Staff Summary of Public Testimony:**

(In support) It is unusual to have a bill that touches on the separation of powers. There is respect for the separation of powers but there are questions about accountability and transparency. This bill is not pointing out where the problems are, it is just trying to increase accountability and transparency. The Legislature has a stake in the success of executive offices. The process of auditing public activities and public agencies is becoming increasingly complex but it is inscrutable to most of our constituents. The judgment of local government comes with a lot of responsibility; it is a fundamental and urgent issue.

It's important that when there are inconsistencies between state and federal reporting requirements, to make sure everyone gets it right in a way that people understand. This bill improves accuracy and integrity of conclusions by state auditors. It also protects local governments from false and defamatory findings. It allows government agencies due process where there currently is none. Currently, the SAO has no effective procedures to guard against various mistakes and deliberate missteps. Washington State is currently the only state to bestow such awesome powers on the SAO. For the past three years the Toppenish School District has had issues with false findings and tried to appeal, to no avail. Last year, the District had a private re-audit which the State Auditor said wasn't binding. The District asked Washington school business officials to re-audit and they found the opposite of what the SAO reported.

Some of the arguments against this bill are, first, that it compromises the opinion of the SAO. That is not the intent, the purpose is to appeal false findings. The state auditor can keep their opinions they just can't report false findings. Second, they say that we are appealing to nonauditors but 99 percent of all findings are legal findings, not accounting-related findings, and thus an auditor is not needed. It is common to hear that disagreements about proposed findings are really differences of professional opinion, but that isn't always the case. There must be verifiable facts before conclusions are reported. It is important to give local agencies the chance to correct serious mistakes, or at least verify facts that reasonably support auditors conclusions, before they are published and cause irreparable harm.

The SAO will argue that it has standards in place to ensure quality control. There have been no complaints against the auditor's standards and practices but no one checks to make sure the practices are applied correctly. This bill gives the opportunity for real, objective review through the administrative review process, which is not new or novel. The auditor is the only one not subject to the review process now. It also gives rule-making authority to the auditor to avoid their concerns about wasteful appeals. Government agencies have to allow the

review of work products to safeguard the citizens they are designed to protect. This bill would set an example for transparency. The SAO did not respond to the defamation suit that was in response to false findings.

No person or agency is capable of keeping a flawless performance. This bill is for when the SAO does not get it 100 percent right and reevaluation may be needed. A careless statement in an audit made public can devastate a family when facts are provided without proof.

There are only four other states where the SAO audits local governments. This bill, giving options to local governments and creating competition, would be a good thing. In terms of a formal appeals processes, we all need checks and balances and this happens in the other four states. Some local governments use private Certified Public Accountant firms for financial audits, however, their work is reviewed and the SAO still conducts an accountability audit. This bill would clarify the option of using private firms for financial audits.

(Opposed) Section 2, regarding the appeals process, is a bigger concern. The SAO is an independent reporting agency that does not have enforcement responsibilities. There is a concern that the appeals process would be used manipulatively, like delaying important findings that would come out right before an election. In regards to transparency and accountability, the SAO provides only opinions. Bond rating agencies use results of audits to establish bond ratings; delays can hurt these local government ratings and cost tax payers. The Constitution established the SAO as an independently elected office for a reason.

Audit standards require that we be independent both in practice and perception, and that we report what we find and how to report those findings. Audit findings are not binding to any official. Audit opinions are professional opinions of auditors who have reviewed documentation and who have applied their professional judgment. It is up to the audited entities to act on the auditors recommendations and any corrections.

The SAO is aware of no other body that has an appeal process similar to the process in this bill. But auditors do provide due process and give officials multiple opportunities to provide additional explanations or materials and at each stage of the audit we reassess. The SAO also sends satisfaction surveys. Over the last eight years, the average score has been 4.4 or higher out of five, which is a really positive result.

Audit standards require both an independent internal quality function and an external peer review every four years. The last peer review in 2013 received the result of "unqualified opinion," which is the highest rating possible.

**Persons Testifying:** (In support) Representative Chandler, prime sponsor; David Andrews, Toppenish School District; David Ridenour, Jeff Carothers, and Peter Roberts, Town of Yacolt; Kelly Roberts; and Greg Kimsey, Clark County Auditor's Office.

(Opposed) Matt Miller and Barb Hinton, State Auditor.

**Persons Signed In To Testify But Not Testifying:** None