

ASSURANCE AND ADVISORY
BUSINESS SERVICES

MARCH 17, 2008



Quality In Everything We Do

General Assembly of Pennsylvania

Financial Statement & Schedule Audit Results & Communications

Report to the Legislative Audit Advisory Commission

Contents

Introductory Letter.....2

Statement on Auditing Standards (SAS) No. 61 Communications.....3

Management Letter5



Ernst & Young LLP
Two Commerce Square
Suite 4000
2001 Market Street
Philadelphia
Pennsylvania 19103-7096

Phone: (215) 448-5000
Fax: (215) 448-4069
www.ey.com

March 17, 2008

Members of the Legislative Audit Advisory Commission
Commonwealth of Pennsylvania

Dear Members of the Legislative Audit Advisory Commission:

We are pleased to present the results of our audits of the statement of financial affairs and schedule of expenditures (the financial statement and schedule) for the fiscal year ended June 30, 2007 of the General Assembly of Pennsylvania.

This report to the Audit Advisory Commission summarizes our audits, the scope of our engagement, and key observations and findings from our audit procedures. The document also contains the communications required by our professional standards to the Audit Advisory Commission.

The audits were designed to express opinions on the financial statement and schedule for the fiscal year ended June 30, 2007. In accordance with professional standards, we obtained a sufficient understanding of internal control to plan the audits and to determine the nature, timing, and extent of tests to be performed. However, we were not engaged to and we did not perform an audit of internal control over financial reporting.

As required by Statement on Auditing Standards No. 61, we are bound to restrict the use of this report to those familiar with the financial operations and systems used to produce the financial statement and schedule. This report is, accordingly, intended solely for the information and use of the Legislative Audit Advisory Commission and management, and is not intended to be and should not be used by anyone other than these specified parties.

We appreciate this opportunity to meet with you to discuss the contents of this report and answer any questions you may have about these or any other audit-related matters.

Very truly yours,

A handwritten signature in black ink that reads 'Stephen A. Baloga'.

Stephen A. Baloga
Partner

Auditors' Responsibilities Under Generally Accepted Auditing Standards (GAAS)

The financial statement and schedule are the responsibility of management. Our audits are financial audits that were designed in accordance with auditing standards generally accepted in the United States to provide reasonable, rather than absolute, assurance that the financial statement and schedule are free of material misstatement. As a part of our audits, we obtained an understanding of internal control sufficient to plan the audit and to determine the nature, timing, and extent of testing performed. However, as is typical for government entities and as allowed under GAAS, we were not engaged to and we did not perform an audit of internal control over financial reporting, i.e. an internal control audit.

We will issue an unqualified opinion on the General Assembly's financial statement and we have already issued an unqualified opinion on the schedule for the fiscal year ended June 30, 2007.

Significant Accounting Policies

The accounting policies are disclosed in the notes to the financial statement and schedule and are consistent with prior years, except for the addition of certain commitments information as further discussed in the notes.

Auditors' Judgments About the Quality of Accounting Principles

Management has consistently applied accounting principles as disclosed in the notes to the financial statement and schedule. Judgments applied and disclosures made are reasonable.

Managements Judgments and Accounting Estimates

There were no significant management judgments on accounting estimates.

Methods of Accounting for Significant Unusual Transactions and for Controversial or Emerging Areas

There were no transactions during the year for which the accounting is in a controversial or emerging area.

Audit Adjustments

We are required to inform the Legislative Audit Advisory Commission about adjustments arising from the audits (whether recorded or not) that could in our judgment either individually or in the aggregate have a significant effect on the financial statement and schedule.

There were no significant audit adjustments, recorded or unrecorded, for the year ended June 30, 2007.

Fraud, and Illegal Acts

During the fiscal year ended June 30, 2007, the Attorney General's Office initiated an investigation into the propriety of supplemental payroll (bonus) payments made to certain General Assembly employees during the fiscal year and other activities of certain employees.

This investigation is ongoing, and we have been informed by management that the impact of the investigation is not expected to have a material effect on the financial statement or schedule for the fiscal year ended June 30, 2007.

Material Weaknesses in Internal Control

We noted no material weaknesses in internal control; however, as described in the attached management letter, we noted significant deficiencies in internal control relating to the General Assembly's financial statement close process and the processing of expenditures through committee and leadership checking accounts for the House of Representatives.

We also noted information technology general controls deficiencies and other items, as described in the attached management letter.

Disagreements with Management on Financial Accounting and Reporting Matters

None.

Serious Difficulties Encountered in Performing the Audit

None.

Major Issues Discussed with Management Prior to Retention

Not applicable.

Consultation with Other Accountants

None.

Independence

We are bound by professional standards as far as independence is concerned. We are not aware of any relationships between Ernst & Young and the General Assembly of Pennsylvania that, in our judgment in accordance with professional standards, may reasonably be thought to bear on our independence.

March 17, 2008

The Legislative Audit Advisory Commission of the
Commonwealth of Pennsylvania

In planning and performing our audit of the financial statement of the General Assembly of Pennsylvania (“the General Assembly”) for the year ended June 30, 2007, in accordance with auditing standards generally accepted in the United States, we considered its internal control over financial reporting (“internal control”) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statement, but not for the purpose of expressing an opinion on the effectiveness of the General Assembly’s internal control. Accordingly, we do not express an opinion on the effectiveness of the General Assembly’s internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity’s ability to initiate, authorize, record, process, or report financial data reliably such that there is more than a remote likelihood that a misstatement of the entity’s financial statements that is more than inconsequential will not be prevented or detected by the entity’s internal control. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity’s internal control.

During our audit, we noted the following matters involving internal control over financial reporting and its operation that we consider to be significant deficiencies, as defined above.

1. Financial Statement Close Process (FSCP)

Observation:

The General Assembly of Pennsylvania is statutorily organized by the Senate, House of Representatives (House), and various legislative service agencies. The Senate and House are further statutorily organized by Republican and Democratic caucuses. Each of these separate

entities and caucuses has independent and differing financial rules and policies (i.e. a decentralized environment). Appropriation activity is tracked internally through financial information systems by each respective entity on the budgetary basis of accounting, and by utilizing the "Status of Appropriations", a report produced by the Pennsylvania Treasury Department, which tracks appropriation activity monthly. Accordingly, the financial information systems and supporting staff utilized by the General Assembly are designed and trained to track appropriation activity on a budgetary basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States (GAAP).

The General Assembly is required to produce entity-wide financial statements annually. Revenue (appropriations) and expenditure activity is included in the financial systems of the Pennsylvania Office of the Budget on a budgetary basis via an interface from the Pennsylvania Treasury Department; however, the General Assembly is also required to provide the Pennsylvania Office of the Budget with the activity or balances consistent with accounting principles generally accepted in the United States (GAAP) for inclusion in the Commonwealth-wide Comprehensive Annual Financial Report.

The decentralized environment and financial systems of the General Assembly are not designed to produce entity-wide financial statements or reflect activity or balances consistent with accounting principles generally accepted in the United States (GAAP).

Beginning in fiscal year ended June 30, 2007, the General Assembly began preparing commitment amounts (e.g. accounts payable, accrued payroll, etc.) to enhance the presentation of its financial statement. These amounts reflect expenditures incurred during the fiscal year, but paid in the subsequent fiscal year, and provide a better analysis of uncommitted funds available at the end of the fiscal year.

Recommendation:

We recommend that the General Assembly consider developing/enhancing the financial statement close process, including centralized financial information systems and controls, necessary to record, process and report financial data consistent with the above noted reporting requirements (entity-wide financial statements, accumulation of commitments related to appropriations and GAAP balances for inclusion in the Commonwealth-wide Comprehensive Annual Financial Report). Listed below are examples, including, but not limited to, financial statement close process and/or financial reporting and related systems enhancements that should be considered:

- System Related Enhancements - implementation of a general ledger system that enhances the General Assembly's ability to initiate, authorize, record, process, and report financial data (by agency) utilizing a double-entry accounting system;
- Financial Reporting Presentation - presenting expenditures by category (e.g. salaries & wages, benefits, rent, furniture, equipment, etc.), by appropriation, in the financial statement may provide users of the financial statement with more detailed information as to natural expenditure classifications; and

- Universal/Centralized Leave Policy - the House of Representatives should consider adopting a universal and centralized leave policy that allows for a consistent and all-inclusive leave tracking system to measure and record accrued leave liability commitments. Such a universal and centralized leave policy would be consistent with that which is currently employed by the Senate of Pennsylvania.

2. Processing of committee and leadership expenditures through conventional checking accounts for the House of Representatives

Observation:

Reimbursement of expenses for various appropriations maintained by committee chairmen and leadership of the House of Representatives is made from contingency accounts (conventional checking accounts), which are also maintained by the respective committee chairmen and leadership.

The Rules of the House of Representatives require committee chairmen and leadership responsible for contingency checking accounts to prepare "Statements of Monthly Expenditures" reports (i.e., Rule 14 reports).

Although the Rule 14 report documents certain expenditure information, it does not appear to always adequately document the specific business/legislative purpose related to each expense item. Failure to document legislative purpose for expenses incurred could subject members/employees to IRS regulations whereby these expenses could be considered income and not expense reimbursements. The House would then be required to complete IRS Form W-2 for such expenses.

Additionally, the advancement method for expense reimbursement inherently contains segregation of duties issues relating to the cash disbursements, cash receipts (advancements) and reconciliation processes.

The recording of expenditures from the conventional checking accounts does not consistently follow the same expense coding or classifications as expenditures made from the Legislative Financial System (LFS). As a result, this would impact the General Assembly's ability of reporting expenditures on an entity-wide basis by expense category.

Recommendation:

Consistent with our prior year recommendation, consideration should be given to consolidating the individual committee and leadership checking accounts into one account controlled by the House Comptroller's Office, similar to the practice currently being utilized by the Senate Chief Clerk's Office. Alternatively, consideration should be given to processing such expense reimbursements by the House Comptroller through the Pennsylvania Treasury Department. Both reimbursement methods would improve internal controls over such funds by subjecting such expenditures to a timely review by the Comptroller's Office. In addition, the legislative purpose should be documented for each expenditure item.

Absent any changes to the current House advancement method of expense payment/reimbursement, consideration should be given to alternative internal control enhancements, including, but not limited to, reduction of advancement and checkbook balance amounts; enhanced descriptions of legislative purpose on Rule 14 reports; the acceleration of checkbook audit procedures and/or the introduction of an internal audit function for more timely and frequent audits; and the coding of expenditures consistent with that of LFS.

Control Deficiencies and Other Matters

During our audit, we also noted the following control deficiencies (as described above) relating to our IT General Controls review of the Legislative Data Processing Committee (LDPC) and other matters we feel are worthy of your attention:

Program Change Management

1. Program Development Monitoring Procedures

Observation:

A periodic monitoring of program changes implemented into the production environment is not performed. Program changes that are inappropriate or unauthorized may be moved into the production environment without management's knowledge or approval. As a result, there is a risk that unauthorized or incorrect program changes can be made.

Recommendation:

We recommend that periodic reviews of program changes implemented to the production environment be conducted to determine that only appropriate and authorized program changes are implemented. Any unknown program updates should be researched and formally approved by management.

2. Segregation of Programming Functions – Change Approver and Developer

Observation:

The LDPC Lead Financial Applications Developer, responsible for making changes to the Legislative Personnel System (LPS) and Legislative Financial System (LFS) applications, is also the person who approves the changes that are migrated into production. Updated program code may be implemented into the production environment without appropriate review and approval. As a result, this segregation of duties concern poses a risk that unauthorized or incorrect program changes will be made without management's approval.

Recommendation:

In an effort to enforce adequate segregation of duties, we recommend that users with the ability to implement changes to the production environment be separated from users with the ability to approve those changes. In the event that this not feasible given the limited resources,

management should institute a reasonable detective control to systematically log and review actual changes made to the application environment.

Logical Access

1. User Access Review

Observation:

User access to the LPS and LFS applications is not being reviewed periodically by the departments that request the user's access. Unauthorized accounts may be created that can be used to perform unauthorized activities. Also, terminated employees might have active accounts with access to the applications if the termination review is not performed properly.

Recommendation:

We recommend that formal, documented procedures be developed and executed for the timely maintenance of User IDs. Management should periodically review user access to critical systems and applications to ensure access granted is reasonable given personnel responsibilities within the organization and the results of those reviews should be documented and retained accordingly.

Other Matters

Legislative financial reserve policies

Observation:

As a matter of good fiscal policy, the General Assembly should consider current measurable commitments (e.g. accounts payable, accrued payroll, lease commitments, etc.) as well as other types of commitments (e.g. post employment retirement benefits for retired employees, future payments of unused employee compensated leave, etc.) in the monitoring and establishment of financial reserves (continuing appropriation balances). Accordingly, the General Assembly should consider maintaining a reasonable, budgetary reserve for continued operations to adequately cover both measurable and estimated costs incurred in the current or prior fiscal years, but payable in subsequent fiscal years.

The General Assembly currently does not have a formally adopted policy to determine the appropriate amount of legislative financial reserves.

Recommendation:

As a best practice, various organizations utilize benchmarking and/or other measures or formulas to determine the appropriate amount of budgetary reserves necessary for continuing operations.

The General Assembly should consider adopting a policy that establishes and monitors the appropriate amount of budgetary reserves to be carried over, or lapsed, between budget cycles.

For example, a possible approach, among others, may be designating a set number of months average or a specific % of current fiscal year appropriations on an appropriation-by-appropriation basis as a budgetary "reserve". Any appropriation (spending authority) surplus in excess of this reserve for a particular appropriation symbol, including prior year appropriations, after commitments (e.g. accounts payable, accrued payroll commitments, etc.), would be lapsed back to the Commonwealth's General Fund by the close of the subsequent fiscal year, to be available for appropriation in the subsequent budget cycle. Such an analysis would be performed after each fiscal year.

As required by generally accepted auditing standards, this communication is intended solely for the information and use of management, the Legislative Audit Advisory Commission, and others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

We would be pleased to discuss the above matters or to respond to any questions, at your convenience.

Ernst + Young LLP

ERNST & YOUNG LLP

www.ey.com

© 2008 Ernst & Young LLP
All Rights Reserved.
Ernst & Young is
a registered trademark.

0801-0902169-PH