General Assembly of Pennsylvania

Financial statement audit results and communications for Fiscal Year Ended June 30, 2013

Report to the Legislative Audit Advisory Commission of the Commonwealth of Pennsylvania

June 18, 2014

Mitchell & Titus

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June 18, 2014

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 audit of the statement of financial affairs (financial statement) for the fiscal year ended June 30, 2013 of the General Assembly of the Commonwealth of Pennsylvania (General Assembly).

This report to the Legislative Audit Advisory Commission summarizes our audit, 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 Legislative Audit Advisory Commission.

The audit was designed to express an opinion on the financial statement for the fiscal year ended June 30, 2013. In accordance with professional standards, we obtained a sufficient understanding of internal control to plan the audit 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. 114, 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. 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,

Stephen A. Baloga

Stephen A. Baloga
Partner

Statement on Auditing Standards (SAS) No. 114 communications

Planned scope and timing of the audit

The timing and scope of the audit has not significantly changed from the scope and timing originally communicated to you in the beginning of our audit.

Auditor’s Responsibilities Under Generally Accepted Auditing Standards (GAAS)

The financial statement is the responsibility of management. Our audit was designed in accordance with auditing standards generally accepted in the United States to provide reasonable, rather than absolute, assurance that the financial statement is free of material misstatement. As a part of our audit, we obtained an understanding of internal control sufficient to plan our audit and to determine the nature, timing and extent of testing performed. However, we were not engaged to and we did not perform an audit of the General Assembly’s internal control over financial reporting.

We concluded that the financial statement that was audited fairly presents, in all material respects, the appropriations, disbursements, commitments, and available balances of the General Assembly for the fiscal year ended June 30, 2013, on the basis of accounting as described in Note 1 to the financial statement.

Please note that attached as Appendix A is our firm’s most recent peer review report.

Qualitative aspects of significant accounting practices, including accounting policies, accounting estimates, and financial statement disclosures

The General Assembly’s accounting policies are summarized in the notes to the financial statement. We believe the General Assembly’s accounting policies are appropriate for the General Assembly’s circumstances.

There were no significant disclosures relating to accounting estimates.

Existing policies, as summarized in the financial statement notes, remained consistent with those of the prior year.

Significant difficulties encountered during the audit

None.

Uncorrected and corrected misstatements

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

There were no audit misstatements, recorded or unrecorded, for the fiscal year ended June 30, 2013, that were considered material to the financial statement.

Disagreements with management significant to the financial statement or auditor’s report

None.

Statement on Auditing Standards (SAS) No. 114 communications *(continued)*

Consultation with other accountants

None.

Other information in documents containing audited financial statements

Our audit was conducted for the purpose of forming an opinion on the statement of financial affairs taken as a whole. The supplementary information included in the schedule of disbursements by category is presented for purposes of additional analysis and is not a required part of the statement of financial affairs. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the statement of financial affairs. The schedule of disbursements by category has been subjected to the auditing procedures applied in the audit of the statement of financial affairs and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the statement of financial affairs or to the statement of financial affairs itself, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated in all material respects, in relation to the statement of financial affairs taken as a whole.

Significant findings or issues discussed, or subject to correspondence with management

None.

Independence

We are not aware of any relationships between Mitchell & Titus and the General Assembly that, in our professional judgment, may reasonably be thought to bear on our independence.

Fraud and illegal acts

None noted.

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.

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February 28, 2014

Management and the Legislative Audit Advisory Commission
Commonwealth of Pennsylvania

In planning and performing our audit of the financial statement of the General Assembly of the Commonwealth of Pennsylvania (General Assembly) as of and for the year ended June 30, 2013, 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 was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies.

A deficiency in internal control 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 and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Significant deficiencies

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.

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, which creates a decentralized environment. Some legislative agencies may also have limited staff available for processing financial transactions and; therefore, could inherently produce segregation of duties issues.

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. As a result, 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 also has been requested to provide the Pennsylvania Office of the Budget with the activity and 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).

Recommendation:

We recommend that the General Assembly consider developing/enhancing the financial statement close process, including centralizing financial information systems and controls necessary to record, process and report financial data consistent with the above-mentioned 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; 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 control 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.

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

Observation:

Reimbursement for varying expenses incurred by certain committee chairmen and leadership of the House of Representatives is made from separate advancement accounts specific to each committee chairman or member of leadership. For banking purposes, such advancement accounts have been established as conventional checking accounts, and are maintained by the respective committee chairmen and leadership.

As a result of a prior year recommendation, the House Comptroller's Office took control over the reimbursement of committee expenses for many smaller House committees (e.g. Labor Relations Committee, Education Committee, Health and Human Services Committee, etc.) during the 2008-2009 legislative session. These committees' chairmen no longer maintain advancement accounts for committee expenses, and now request reimbursement of associated expenses through the House of Representatives Comptroller's Office. However, advancement accounts for larger committees (e.g. Appropriation Committees, Administration for Staff Committee, etc.) and leadership (e.g. Speaker's Office, Caucus Secretary, etc.) remain open. Additionally, two of the larger committees process payroll through these types of advancement accounts, rather than through the Pennsylvania Treasury Department.

The Rules of the House of Representatives require committee chairmen and leadership responsible for advancement 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 adequately document the specific business or legislative purpose related to each expense item on a consistent basis. Failure to document legislative purpose for expenses incurred could subject members or employees to IRS regulations associated with deeming such expenses as income instead of expense reimbursements, which would require the House to include such expenses in the respective members' or employees' annual IRS Forms W-2.

The recording of expenditures from the advancement accounts does not consistently follow the same expense coding or classifications as expenditures made from the Legislative Financial System (LFS). As a result, this impacts the General Assembly's ability to report expenditures on an entity-wide basis by expense category. Additionally, the current advancement method for expense reimbursement, including payroll, contains a lack of segregation of duties relating to the cash disbursements, cash receipts (advancements) and reconciliation processes because those initiating transactions may also be the ones approving them. The following is a listing of items noted during our audit relating to the processing of transactions through these individual conventional checkbook accounts:

- In a number of instances, Rule 14 reports and/or check registers contained clerical errors including incorrect dates; incorrect expenditure amounts; incorrect check numbers; checks written out of sequential order; and expenses, deposits and voided checks not recorded accurately. Corrections were needed for these errors.

- A Rule 14 report was not provided; or the custodian did not always submit a revised Rule 14 report to the Chief Clerk's office. Follow up was needed to secure appropriate Rule 14 reports.

- Bank adjustments were recorded in the register with the wrong date; and an incorrect checkbook balance was calculated at year-end.

- A custodian did not maintain a checkbook and did not reconcile the cash amount to their monthly bank statement.

- In many situations there is limited segregation of duties. Consideration should be given to having the monthly bank reconciliations that are completed by the custodians reviewed by an individual independent from the checkbook process.

- In a few instances late fees and interest for late payment were paid.

- A $123 floral purchase was made as a gratuity for a service provider; current policies should be considered prior to incurring these types of expenses.

- Funds were advanced onto a vendor (Starbucks) rewards card instead of paying directly for the purchased items (i.e. the receipt was provided for the prepayment, not upon the usage of the card). This practice can obscure the nature of the actual items being purchased.

- Sales tax is occasionally being paid on potentially exempt purchases.

- The payee signed a check payable to himself/herself or made a check payable to his/her personal credit card. Although receipts were provided for such transactions, consideration should be given to requiring the second signer on the account to sign such checks and prohibit a signatory from signing a check made out to himself/herself or their own personal credit card.

- Many Rule 14 report descriptions in the "Expenditure Description" column are general (e.g. Breakfast, Dinner, Snacks & beverages, etc.). Consideration should be given to adding a "legislative purpose" column on the standard Rule 14 report and including the signature of the member attesting to, as stated on the standard Legislative Expense Voucher, "The statements and expenses claimed are correct and were incurred by me in the performance of my legislative duties; I have not requested and will not request reimbursement for such items from any other source."

- Check register transaction descriptions are sometimes vague.

- Occasionally credit card receipts or statements (non-itemized) were used as supporting receipts for meals and other purchases. Consideration should be given to requiring detailed restaurant receipts for supporting documentation, listing the names of individuals in attendance for meals and documenting the legislative purpose for the meal.

- Consideration should be given to expanding and documenting the Rule 14 report review (and revision, if necessary) process. In addition to existing procedures to confirm receipt, additional accuracy review procedures could include, but not be limited to, reviewing check number sequences for skipped or duplicate check numbers, checking accuracy of disbursement dates and other information, reviewing expenditure descriptions for reasonableness, etc.

- Consideration should be given to requiring custodians to obtain copies of cancelled checks or check images. Cancelled checks or check images could be used to match against each expenditure to ensure payee and signer are not the same, as well as ensuring payee information matches the information on the check register as an internal control. Cancelled check images are not always maintained by the cash account custodian.

- Consideration should be given to what bank is being utilized for the checkbook and type of account being maintained to avoid unnecessary service charges (e.g. check images are included or provided at no charge).

- Some accounts are maintaining significant checking account balances and are not earning interest. Consideration should be given to periodically analyzing checkbooks with large balances to determine if better net returns could be achieved and earnings net of fees could be returned to the Commonwealth Treasury.

Recommendation:

Consistent with our prior-year recommendation, consideration should be given to consolidating the committee and leadership advancement 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 could be given to processing such expense reimbursements by the House Comptroller through the Pennsylvania Treasury Department. Either reimbursement method would improve the design of internal controls over such funds by subjecting such expenditures to a review by the Comptroller's Office – providing for a review of documentation of the legislative or business purpose and an enhancement to the segregation of duties.

Absent any changes to the current House advancement method of expense payment and reimbursement, consideration should be given to alternative internal control enhancements, including, but not limited to, a reduction of available advancement balance amounts, enhanced descriptions and review of legislative purpose included on Rule 14 reports, the processing of all payroll transactions through the Pennsylvania Treasury Department, 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.

Legislative financial reserve policies

Observation:

As a matter of good fiscal policy, the General Assembly may consider current measurable commitments (e.g., invoices 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 its monitoring and establishment of financial reserves and continuing appropriation balances. Accordingly, the General Assembly could consider maintaining a reasonable, budgetary reserve for continued operations to adequately fund 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 leading practice, various organizations utilize benchmarking or other measures or formulas to determine the appropriate amount of budgetary reserves necessary for continuing operations.

The General Assembly could 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 percentage of current fiscal year appropriations on an appropriation-by-appropriation basis in establishing a budgetary "reserve." Appropriation surpluses 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 to the Commonwealth's General Fund by the close of the subsequent fiscal year – available for appropriation in the subsequent budget cycle. Such an analysis would be performed after each fiscal year.

As required by auditing standards generally accepted in the United States, 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.

Mitchell & Titus, LLP

About Mitchell & Titus
Mitchell & Titus, LLP is the preeminent minority-controlled professional services firm offering Assurance, Tax and Advisory services in the US. Our inclusive environment and diverse thinking result in creative options for our clients. As a member firm of
Ernst & Young Global Limited, clients can tap into a wide array of sophisticated, global services. At the same time, Mitchell & Titus' heritage of quality and seasoned professionals bring varied insight
to every engagement. For more information about our organization, please visit mitchelltitus.com.

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About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

Appendix A

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SYSTEM REVIEW REPORT

To the Shareholders of Mitchell & Titus, LLP
and the National Peer Review Committee

We have reviewed the system of quality control for the accounting and auditing practice of Mitchell & Titus, LLP (the firm) applicable to non-SEC issuers in effect for the year ended February 28, 2013. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. As a part of our peer review, we considered reviews by regulatory entities, if applicable, in determining the nature and extent of our procedures. The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility is to express an opinion on the design of the system of quality control and the firm's compliance therewith based on our review. The nature, objectives, scope, limitations of, and the procedures performed in a System Review are described in the standards at www.aicpa.org/prsummary.

As required by the standards, engagements selected for review included engagements performed under *Government Auditing Standards,* audits of employee benefit plans, and audits of carrying broker-dealers.

In our opinion, the system of quality control for the accounting and auditing practice applicable to non-SEC issuers of Mitchell & Titus, LLP in effect for the year ended February 28, 2013, has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. Mitchell & Titus, LLP has received a peer review rating of ***pass***.

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP

Charlotte, North Carolina
July 26, 2013