

MANAGEMENT DIRECTIVE

Commonwealth of Pennsylvania Governor's Office

Subject: Review of Auditor General, Treasury, Legislative Budget and Finance Committee, and Other Audit Reports	Number: 325.10 Amended
Date: August 27, 2009	By Direction of:  Mary A. Soderberg, Secretary of the Budget
Contact Agency: Office of the Budget, Office of Comptroller Operations, Bureau of Audits (BOA), Telephone 717-783-0114	

This directive establishes policy, responsibilities, and procedures for reviewing, evaluating, responding to, and implementing follow-up action for audit reports issued by the Department of the Auditor General, Treasury, Legislative Budget and Finance Committee, and other auditors (hereinafter referred to as "audit reports"). Policy, responsibilities, and procedures have been updated as a result of the reorganization of the Office of the Budget, Office of Comptroller Operations. Marginal dots are excluded due to major changes.

1. **PURPOSE.** To establish policy, responsibilities, and procedures for reviewing, evaluating, responding to, and implementing follow-up action for audit reports.
2. **SCOPE.** This directive applies to all departments, boards, commissions, and councils (hereinafter referred to as "agencies") under the Governor's jurisdiction, and is effective with audit reports after December 31, 2008.
3. **OBJECTIVES.**
 - a. To ensure that audit reports are used as a management tool to strengthen governmental operations.
 - b. To ensure that audit reports are reviewed, evaluated, responded to, and followed-up in an effective, consistent, and timely manner.

4. DEFINITIONS.

- a. **Agency Audit Report Review Plan (AARRP).** A tool used jointly between the agency and BOA management which details specific procedures for reviewing, evaluating, and responding to audit reports and for implementing follow-up action.
- b. **Audit.** An independent examination or appraisal of the diverse operations and controls within an agency for use as a management tool to determine whether financial statements and transactions are fairly stated; applicable policies, procedures, and principles are followed; established standards are met; resources are used efficiently and economically; and the organization's objectives are being achieved. For purposes of this directive, an audit may also include an attestation engagement, or a limited scope activity or engagement performed by Treasury auditors (such as a random field audit, routine field audit, or internal control structure review), or similar activities or engagements performed by the Department of the Auditor General, Legislative Budget and Finance Committee, or other auditors.
- c. **Audit Report.** A formal written document disclosing the results of the audit process. The audit report is the culmination of audit efforts, describing what has been reviewed, found, and makes recommendations, when applicable, to correct any noted problems. For purposes of this directive, an audit report may also include a report or memorandum issued upon the completion of an attestation engagement or a limited scope activity or engagement performed by Treasury auditors (such as a random field audit, routine field audit, or internal control structure review), or similar activities or engagements performed by Department of the Auditor General, Legislative Budget and Finance Committee, or other auditors.
- d. **Audit Report Evaluation Criteria.** Formalized standards to be applied during the audit report review and evaluation process as a means of determining the validity, merit, and acceptance of audit report findings and recommendations and their application to agency organizations, programs, activities, and functions.
- e. **Audit Report Reply Criteria.** Formalized standards to be applied during the audit report response process to ensure that agency responses to audit reports are prepared in a concise, thorough, and timely manner, clearly indicating the results of the review and evaluation process, including strengthening, correcting, or other actions to be effected.
- f. **Audit Review Committee (ARC).** A committee established by an agency head to coordinate and perform, or direct the performance of, the audit report review, evaluation, response, and follow-up process. The ARC also coordinates and performs, or directs the performance of, the single audit resolution process in accordance with *Management Directive 325.7, Implementation of the Commonwealth's State-Level Single Audit*.
- g. **Deputy Secretary for Comptroller Operations.** Office of the Budget, Office of Comptroller Operations, Chief Accounting Officer.

5. POLICY.

- a.** Audit reports shall be used by commonwealth management as a tool to assist in monitoring, evaluating, controlling, and strengthening governmental operations.
- b.** Procedures and methodology for reviewing, evaluating, and responding to audit reports shall be established within agencies.
 - (1)** Such procedures should be tailored to the different types of audit reports.
 - (2)** Such procedures and methodology shall be developed and implemented to meet individual agency needs in accordance with the policy, responsibilities, and procedures contained in this directive.
 - (3)** Review and evaluation procedures shall include the minimum criteria specified in Enclosure 1, Audit Report Evaluation Criteria.
 - (4)** Response procedures shall include the minimum criteria specified in Enclosure 2, Audit Report Reply Criteria.
 - (5)** The procedures and methodology shall be formally documented in an AARRP and approved by the agency head. The AARRP shall be revised, when necessary, to meet agency needs.
- c.** An ARC shall be established within each agency to coordinate and perform, or direct the performance of, the review, evaluation, and response process, including the conduct of related follow-up action. The chairperson of each ARC shall be the Deputy Secretary for Administration, or equivalent, in each agency. Other committee members may vary to meet agency needs.
- d.** Subcommittees of the ARC may be established, when necessary, under the primary ARC to assist in the performance of the review, evaluation, and response process including the performance of related follow-up action. Normally, subcommittees would be established when audit reports pertain to field operations such as institutions or local offices; therefore, require reviews at a decentralized level or for review and resolution of subrecipient audit reports.
- e.** Agency reviews and evaluations of audit reports, and the preparation and transmittal of related responses thereto, shall be completed in accordance with the auditor's transmittal letter but no later than 60 days from the date audit reports are submitted to agencies for review.
- f.** Proposed strengthening, correcting, or other actions shall be performed or implemented as a result of audit report findings and recommendations when it is determined, after completing the review and evaluation process, that such actions have merit and specific application and can be effected in an efficient, economic, and effective manner. All planned actions shall be implemented as soon as possible to meet agency needs, but no later than six months from the date of the initial agency response to the audit report, unless special circumstances deem such implementation schedule to be impractical.

- g.** Follow-up procedures shall be developed, implemented, and performed to ensure that required strengthening, correcting, or other actions have been, are being, or will be effected as planned. Follow-up procedures shall be documented as part of the AARRP.
- h.** The ARC shall prepare regular reports of the status of new and unresolved prior audit findings, using guidance provided in Enclosure 3, Guidance for Preparation of Status Reports of New and Unresolved Prior Audit Findings, as a basis for controlling agency compliance for report review, evaluation, response, and follow-up. Reports shall be prepared no less frequently than semiannually and distributed to the agency head and BOA.
- i.** BOA shall monitor ongoing agency conformance to this directive, the AARRP, and the agency follow-up process to determine its effectiveness and adequacy for ensuring the satisfactory implementation of required strengthening, correcting, or other actions. BOA shall prepare reports, as needed, disclosing the results of monitoring performed. Such reports shall be distributed to the agency head and the Deputy Secretary for Comptroller Operations, as appropriate.
- j.** Requests for exceptions to stated policy and procedures must be made, in writing, by the agency head to the Deputy Secretary for Comptroller Operations with complete justification. BOA shall issue written approvals or disapprovals to the agency head, in accordance with the decision of the Deputy Secretary for Comptroller Operations.

6. RESPONSIBILITIES.

a. Deputy Secretary for Comptroller Operations.

- (1)** Directs the development of policy and procedures for reviewing, evaluating, and responding to audit reports, including the performance of related follow-up action by agencies.
- (2)** Consults with agencies and BOA on technical matters relating to the audit report review, evaluation, response, and follow-up process.
- (3)** Addresses any major problems or other areas of concern relating to the audit report review, evaluation, response, and follow-up process that cannot be resolved at the agency or BOA level, and acts as liaison between the Secretary of the Budget and the agency head on such matters.
- (4)** Ensures that the Secretary of the Budget receives copies of audit reports and related documents that may materially impact commonwealth organizations, programs, activities, and functions, for review and initiation of any further action.
- (5)** Reviews and approves or disapproves agency requests for exceptions to stated policy and procedures.

b. Office of the Budget, Office of Comptroller Operations, Bureau of Audits.

- (1) Provides technical support and expertise relating to the audit report review, evaluation, response, and follow-up process to the Deputy Secretary for Comptroller Operations.
- (2) Provides technical support and expertise relating to the audit report review and follow-up process to agencies.
- (3) Acts as liaison between the Department of the Auditor General, Treasury, Legislative Budget and Finance Committee, or other auditors and agencies relative to the audit report review, evaluation, response, and follow-up process.
- (4) Addresses any major problems or other areas of concern relating to the audit report review, evaluation, response, and follow-up process that cannot be resolved at the agency level.
- (5) Communicates with the Deputy Secretary for Comptroller Operations on technical matters relating to the audit report review, evaluation, response, and follow-up process, or problem areas that cannot be resolved at the agency or BOA level.
- (6) Maintains or coordinates the maintenance of file copies of audit reports, related agency responses, status reports of new and unresolved prior audit findings, and other pertinent documents and material for monitoring purposes.
- (7) Ensures that the Deputy Secretary for Comptroller Operations receives copies of audit reports and related documents that may materially impact commonwealth organizations, programs, activities, and functions, for review and initiation of any further action.
- (8) Communicates with the ARC chairman and/or the agency head concerning incomplete responses or actions to audit reports, or other deficiencies or matters disclosed during the monitoring process.
- (9) Performs general oversight of audit report review, evaluation, response, and follow-up process to ensure conformance and economy, efficiency, and effectiveness of performance.
- (10) Monitors ongoing agency conformance to policy and procedures relating to audit report review, evaluation, response, and implementation and follow-up process of corrective action.
- (11) Prepares reports to the agency head, as needed, disclosing the results of the monitoring of agency review, evaluation, response, and follow-up action.

c. Agency Head.

- (1) Approves an AARRP containing procedures for effectively reviewing, evaluating, and responding to audit reports including the performance of related follow-up action.
- (2) Directs the implementation of commonwealth policy relative to audit report review, evaluation, response and follow-up process.
- (3) Establishes an agency ARC and directs that it perform responsibilities in accordance with this directive.
- (4) Approves and signs, as appropriate, formal agency responses to audit reports and transmits such responses directly to the auditing agency, with copies to BOA, ARC, and other appropriate executive branch officials.
- (5) Ensures that required strengthening, correcting, or other actions identified during the audit report review, evaluation, response, and follow-up process have been, are being, or will be implemented as planned.

d. Audit Review Committee.

- (1) Develops and implements internal procedures for effectively reviewing, evaluating, and responding to audit reports including the performance of related follow-up action.
- (2) Documents audit report review, evaluation, response, and follow-up process in a formal AARRP.
- (3) Establishes ARC subcommittees when necessary.
- (4) Coordinates and performs, or directs the performance of, reviews and evaluations of audit reports in accordance with this directive and the AARRP.
- (5) Coordinates or directs the preparation of formal agency responses to audit reports and, where appropriate, for approval and signature of the agency head, and ensures that such responses conform to this directive and the AARRP.
- (6) Coordinates and performs, or directs the performance of, follow-up action to audit reports in accordance with this directive and the AARRP.
- (7) Coordinates the preparation of, or prepares, semiannual written status reports for the agency head, disclosing the results of the follow-up process.

7. PROCEDURES.

- a. Action By: Agency Head.** Establishes an agency ARC to perform responsibilities in accordance with this directive.

b. Action By: Audit Review Committee.

- (1) Documents agency audit report review, evaluation, response, and follow-up process in a formal AARRP, approved by the agency head.
- (2) Transmits a copy of the AARRP to the agency head and BOA.

c. Action By: Auditors.

- (1) Performs audits and issues audit reports to agency heads, BOA, and other appropriate officials as follows:

(a) Department of the Auditor General.

- 1 Three copies to the agency head.
- 2 One copy to the Governor.
- 3 One copy to the Director of BOA.

(b) Treasury.

- 1 One copy to the agency Deputy Secretary for Administration or equivalent.
- 2 One copy to the Director of BOA.
- 3 One copy to the Director of the Office of the Budget, Office of Comptroller Operations, Bureau of Financial Management (BFM).

(c) Legislative Budget and Finance Committee.

- 1 One copy to the agency head and to each member where audit is of a board or commission.
- 2 One copy to the Governor.
- 3 One copy to the Lieutenant Governor.
- 4 One copy to the Secretary of the Budget.
- 5 One copy to the Secretary of Administration.
- 6 One copy to the Director of BOA.
- 7 One copy to the Governor's Office Press Secretary.
- 8 Copies to appropriate Legislative branch officials.

d. Action By: Office of the Budget, Office of Comptroller Operations, Bureau of Audits.

- (1) Maintains a central library of audit reports and monitors agency/ARC review, evaluation, response, and follow-up.
- (2) Performs a general review of audit reports to determine if any major issues require the immediate attention of the Deputy Secretary for Comptroller Operations.
- (3) Prepares and addresses a transmittal letter to the Secretary of the Budget from the Deputy Secretary for Comptroller Operations, detailing issues that may materially impact commonwealth organizations, programs, activities, and functions, including copies of audit reports and related documents.

e. Action By: Deputy Secretary for Comptroller Operations.

- (1) Upon concurrence, signs the transmittal letter and transmits it, with copies of the audit reports and related documents, to the Secretary of the Budget for any further action.
- (2) Transmits a copy of signed transmittal letter to the agency head and BOA for information.

f. Action By: Agency Head. Transmits audit reports and transmittal letters from the Deputy Secretary for Comptroller Operations to ARC to initiate review, evaluation, response, and follow-up process.

g. Action By: Audit Review Committee.

- (1) Coordinates and performs, or directs the performance of, the review and evaluation of audit reports in accordance with this directive and the AARRP.
- (2) Coordinates the preparation of or prepares formal agency responses to audit reports for approval and signature of the agency head in accordance with this directive and the AARRP.

NOTE: When an audit report contains no findings and recommendations, a formal agency response must be prepared for the agency head's signature evidencing its receipt and review.

h. Action By: Agency Head.

- (1) Reviews agency responses to audit reports and, upon approval, signs.
- (2) Transmits original response to the auditors with copies distributed to BOA, ARC, and other appropriate executive branch officials.

i. Action By: Audit Review Committee. Coordinates and performs, or directs the performance of, follow-up action to audit reports in accordance with this directive and the AARRP.

- j. **Action By: Agency Head.** Ensures that required strengthening, correcting, or other actions have been, are being, or will be implemented as planned as a result of the audit report.
- k. **Action By: Audit Review Committee.** Prepares status reports of new and unresolved prior audit findings, no less frequently than semiannually, and distributes to the agency head and BOA.
- l. **Action By: Office of the Budget, Office of Comptroller Operations, Bureau of Audits.**
 - (1) Monitors agency conformance to commonwealth and internal policy and procedures relative to audit report review, evaluation, response, and follow-up process to determine its adequacy and effectiveness.
 - (2) Communicates to agency heads and, as necessary, to the Deputy Secretary for Comptroller Operations, the results of ongoing monitoring of the process.

Enclosure 1 - Audit Report Evaluation Criteria

Enclosure 2 - Audit Report Reply Criteria

Enclosure 3 - Guidance for Preparation of Status Reports of New and Unresolved Prior Audit Findings

This directive replaces, in its entirety, *Management Directive 325.10*, dated August 31, 1994.

AUDIT REPORT EVALUATION CRITERIA

Agencies are to apply the following minimum criteria to audit disclosures (findings and recommendations) contained within audit reports as a means of determining and evaluating the merit, acceptance, and application of such findings and recommendations to agency organizations, programs, activities, and functions.

Based on the results of the review and evaluation of the audit report, the agency shall prepare its response to the auditors using the criteria listed in Enclosure 2, Audit Report Reply Criteria.

Accuracy and Completeness. Ensure that findings, conclusions, and related recommendations are based on complete, accurate, and factual data disclosed during the audit process. The audit report review process shall determine that broad conclusions and related recommendations are not based on isolated instances or events that may not be representative of the whole.

Bias. Determine that findings, conclusions, and related recommendations are indicative of objective, fair, and independent reporting, and that personal or organizational bias on the part of the auditor or audit organization does not exist.

Corrective Action. Ensure that corrective action for a particular condition has not already been taken before the issuance and receipt of the audit report. Audit report responses should clearly disclose any strengthening, correcting, or other actions taken subsequent to the audit, but prior to the issuance and receipt of the related audit report.

Cost Effectiveness. Ensure that the implementation of recommended actions will be cost effective in relation to benefits received and/or the reduction in exposure to potential adverse risks.

Legality. Determine that findings, conclusions, and related recommendations conform to applicable state and federal laws, regulations, and other compliance factors. However, when audit disclosures support the need for new or revised legislation, regulations, or other compliance elements, such action shall be pursued and plans referenced in the audit report response process.

Perspective. Determine that findings, conclusions, and related recommendations took into consideration any commonwealth or agency broad range policies, goals, or objectives relevant to particular organizations, programs, activities, or functions.

Relevancy. Ensure that findings, conclusions, and related recommendations are formulated from objective, factual, and actual evidence that is directly applicable to individual situations.

Timeliness. Ensure that findings, conclusions, and related recommendations contained in audit reports are directly relevant to current conditions and have not become outdated or inapplicable as a result of the passage of time between the conduct of an audit and the issuance of the audit report.

AUDIT REPORT REPLY CRITERIA

Agencies shall apply the following minimum criteria in the preparation of formal responses to audit reports.

General Criteria

Responses to audit reports shall be addressed to the Department of the Auditor General, Treasury, Legislative Budget and Finance Committee, or other auditors, as appropriate, signed by agency heads, and submitted to the appropriate audit official in accordance with the auditor's transmittal letter but no later than 60 days from the date audit reports are submitted to agencies for review.

Each finding and related recommendation contained within audit reports (prior and current year disclosures) shall be addressed and identified separately in agency responses, in the same sequence presented in the audit reports.

Responses shall detail the results of the review and evaluation of each audit finding and related recommendation contained in audit reports, applying the response criteria described below. The agency must ensure that responses clearly describe the agency's concurrence or nonconcurrence with individual findings and recommendations, and reasons therefore. The response must also document planned actions to be effected by the agency, including a timetable of implementation, as a result of the audit report review and evaluation process.

Response Criteria

Accurate and Factual Data, Adequacy of Support. Present factual data accurately and fairly. Include only information that is supported by sufficient evidence to demonstrate or prove the basis for the matters reported and their correctness and reasonableness.

Appendices. Computer listings, analyses, charts, graphs, etc., which support, explain, or supplement information in the reply, should be presented as appendices.

Clarity and Simplicity. Replies must be clear and simple. If technical terms and unfamiliar abbreviations must be used, they should be clearly defined.

Completeness. Although replies should be concise, they must be complete. Replies should contain sufficient information to promote adequate understanding of the matters reported and to provide convincing presentations. Sufficient background information should be included.

Conciseness. The replies should be no longer than necessary. Too much detail detracts from a reply; may even conceal the real message; and may confuse the readers; however, sufficient detail must be present to provide a meaningful response.

Constructiveness of Tone. The tone of replies should encourage favorable reaction by the readers. Titles, captions, and the text of replies should be stated constructively. Although replies should be presented in clear, forthright terms, the preparers should keep in mind that their objective is to obtain favorable reaction and that this can best be done by avoiding language that unnecessarily generates defensiveness and opposition.

Convincingness. Responses must be presented in a convincing manner and conclusions and recommendations must follow logically from the facts presented. The information in replies must be sufficient to persuade the auditors of the importance of the replies, the reasonableness of the conclusions, and the desirability of their accepting the conclusions.

Objectivity. Replies should be presented objectively and should include sufficient information to give a proper perspective. The reply should be fair and not misleading and should place primary emphasis on matters needing attention.

GUIDANCE FOR PREPARATION OF STATUS REPORTS OF NEW AND UNRESOLVED PRIOR AUDIT FINDINGS

Audit resolution for a finding begins when an agency receives its initial notification of an audit issue. At that time, the agency begins formulating its position on an issue which is included in its agency response to the audit report, in its corrective action plan, and later, in the agency status report.

The ARC should prepare, or coordinate the preparation of, status reports which address all new findings and recommendations from audit reports issued during the past six months (or since the completion of the most recent status report), and all findings and recommendations from prior audits which were listed as unresolved in the most recent status report. Status reports should be prepared on a regular basis, but no less frequently than semiannually. Upon completion, the committee chairperson shall sign such reports after a review for completeness and accuracy. Status reports should be distributed to both the agency head and BOA for their information and review.

The format of status reports shall be tailored to meet specific agency needs, but at a minimum, should include the following for each new or unresolved prior audit finding and recommendation:

- (1) Audit report information including the audit organization, audit period, and organization, program, activity or function subject to audit.
- (2) Finding number and finding title as listed in the audit report, in the same sequence as listed in the original report.
- (3) A "RESOLVED" or "UNRESOLVED" status to indicate whether the issue has been resolved or whether resolution is pending.
- (4) Comments regarding the current status of resolution.

At a minimum, the comments should address the status of implementation of proposed strengthening, correcting, or other necessary actions and conformance to original timetables; any additional actions to be taken, together with a proposed timetable; relevant comments, or major problems encountered concerning the implementation process; any suggested or required revisions to proposed actions and related timetables presented in the original agency audit report response; and any other pertinent data. Findings should be considered unresolved until all corrective action steps have been implemented. Where corrective action has been completed and the agency considers the finding resolved, status report comments should indicate the specific action(s) taken.

Findings may also be considered resolved when no corrective action is necessary. This may include instances where the agency clearly disagrees with the finding and recommendation; where the finding was subsequently proved invalid; or where the issue resulted from a one time clerical error which is self-correcting and not indicative of an internal control weakness. In these situations, status report comments should clearly indicate the reasons why corrective action is not warranted.