



Management Directive

Commonwealth of Pennsylvania

Governor's Office

Management Directive 325.02 Amended – Audit Inquiry Relative to Agency Litigation, Claims, and Assessments

Date: November 1, 2021
By Direction of: *Greg Thall*
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This directive establishes policy, responsibilities, and procedures for initiating responses to Letters of Audit Inquiry (LAI) relative to agency litigation, claims, and assessments prepared and issued by Independent Auditors during the normal audit process and updates references to the Annual Comprehensive Financial Report (ACFR), State-Level Single Audit, and Governmental Accounting Standards Board (GASB).

1. PURPOSE.

To establish uniform policy, responsibilities, and procedures for processing responses to LAI.

2. SCOPE.

- a. This directive applies to all departments, offices, boards, commissions, and councils (hereinafter referred to as "agencies") under the Governor's jurisdiction.
- b. This directive applies to LAI relative to agency litigation, claims, and assessments prepared by Independent Auditors during audits of the Commonwealth's basic financial statements and federal awards programs, also known as the ACFR and State-Level Single Audits. Similar policy and procedures should be adopted, as applicable, for other audits of agencies and programs.

3. OBJECTIVE.

To ensure that agencies and agency counsel understand the nature and importance of LAI to agency litigation, claims, and assessments and that responses are prepared within the framework required by generally accepted auditing standards and American Bar Association standards during the conduct of the Commonwealth's ACFR and State-Level Single Audits.

4. DEFINITIONS.

- a. **Commonwealth Legal Counsel.** With respect to LAIs, Commonwealth Legal Counsel refers to agency counsel, the Office of General Counsel (OGC), the Office of Attorney General (OAG), and outside counsel providing legal representation to the Commonwealth.
- b. **Commonwealth Financial Reporting Entity.** Includes all funds, agencies, and other entities for which elected Commonwealth officials are responsible (primary government) and legally separate organizations (established as independent agencies) for which the Commonwealth itself is financially accountable or for which exclusion would result in misleading financial statements.
- c. **Independent Auditors.** Auditors within the Department of the Auditor General or a public accounting firm responsible for performing the Commonwealth's financial audit under the adherence to generally accepted governmental auditing standards and requirements of independence.
- d. **Letter of Audit Inquiry (LAI).** An inquiry of an agency's counsel concerning litigation, claims, and assessments, both asserted and unasserted, against that agency (as per GASB Statement #62). The LAI is the Independent Auditors' primary means of obtaining information relative to actual or potential litigation, claims, and assessments that may have a material impact on the financial statements and federal awards programs under audit.
- e. **State-Level Single Audit.** A financial audit, as defined in [*Government Auditing Standards*](#), of the Commonwealth's organizations, programs, activities, functions and federal awards under the provisions of *2 C.F.R. Part 200, Subpart F – Audit Requirements*.

5. POLICY.

- a. Audits of Commonwealth organizations, programs, activities, and functions are to be made, where applicable, in accordance with generally accepted government auditing standards and policy established in *Management Directive 325.03, Performance of Audit Responsibilities*.
- b. An Independent Auditor ordinarily does not possess legal expertise and, therefore, cannot and should not make legal judgments and determinations regarding Commonwealth litigation, claims, and assessments disclosed during the normal audit process without first addressing such issues with Commonwealth Legal Counsel. Therefore, Independent Auditors normally direct an LAI to the Commonwealth, which seeks responses from

Commonwealth Legal Counsel providing legal representation to it. For the Commonwealth's ACFR and State-Level Single Audits, the Independent Auditors request LAI information from the Office of the Budget, Deputy Secretary of Comptroller Operations (DSCO) acting as the audit liaison, who, in conjunction with OGC, requests LAI information from each agency included in the scope of the respective audit. For all other audits, the Independent Auditors will request LAI information directly from the agency being audited.

Note: Failure to respond properly to the LAI may impair the scope of the Independent Auditors' audit and may adversely affect the Independent Auditors' opinion rendered on the financial statements being audited.

- c. OGC, acting as legal counsel for the Commonwealth, coordinates preparation of requests for information from affected agencies and submission of responses to the Independent Auditors.
- d. Responses to LAIs submitted by Commonwealth Legal Counsel must be prepared in accordance with OGC 's annually distributed guidelines for responses to audit inquiry, contained in the LAI packages referenced in Sections 6.h.(1) and 7.c. of this directive.
- e. Responses to LAIs must be addressed on a priority basis and prepared timely. In order to meet time constraints specified by the Independent Auditors, agencies must prepare both a preliminary and final response in relation to the ACFR audit and an updated final response in relation to the State-Level Single Audit, and submit them to OGC in accordance with established timeframes. Information contained within a response should encompass the period from the date of the prior response up to and including the actual date of the current response for a given audit.
- f. Minimum reportable monetary materiality limits with regard to agency litigation, claims, and assessments are established by the Independent Auditors and communicated in the LAI request.
- g. The Independent Auditors will assess the impact of litigation, claims, and assessments on the Commonwealth's basic financial statements and federal awards programs, in accordance with generally accepted government auditing standards.

6. RESPONSIBILITIES.

a. Agency Counsel shall:

- (1) Ensure that the preliminary, final, and updated final agency responses to OGC concerning litigation, claims, and assessments are appropriately researched, accurately and completely prepared in conformance with the procedures herein and submitted within established timeframes.
- (2) Request the OAG and outside counsel provide current information concerning matters being handled on their behalf for incorporation in preliminary, final, and updated final agency responses to OGC. This includes matters of litigation, claims, and assessments that are agency-specific and where the agency is directly represented by the OAG or outside counsel on general Commonwealth matters affecting the agency.

- b. Agency Counsel and Department of General Services (DGS) shall** determine tort actions against the Commonwealth pursuant to the *Sovereign Immunity Act, 42 Pa.C.S. §§ 8521-8528*.
- c. Agency Head shall** review preliminary, final, and updated final agency responses to the LAI to ensure completeness.
- d. OAG shall** provide current information to agency counsel concerning matters being handled by the OAG on behalf of agencies for incorporation in preliminary, final, and updated final agency responses to OGC.
- e. DSCO shall** coordinate the preparation of Commonwealth responses to the Independent Auditors' LAI requests.
- f. Independent Auditors shall:**
 - (1)** Transmit LAI request for summary of litigation, claims, and assessments to the DSCO and BAFM.
 - (2)** Review preliminary, final, and updated final agency responses to their LAI request and assess whether the Commonwealth is properly reporting and disclosing the impact of litigation, claims, and assessments on the Commonwealth's basic financial statements and federal awards programs as part of the normal audit process.
- g. BAFM shall:**
 - (1)** Provide technical assistance, when needed, relative to the LAI process.
 - (2)** Prepare materials for the LAI package for review and distribution by OGC.
 - (3)** Maintain records of all litigation, claims, and assessments disclosed in agency responses and prepare appropriate summary reports.
- h. OGC shall:**
 - (1)** Coordinate the issuance of individual LAI packages to agencies and the receipt of preliminary, final, and updated final agency responses.
 - (2)** Review all preliminary, final, and updated final agency responses.
 - (3)** Provide to the Independent Auditors all preliminary, final, and updated final agency responses.
 - (4)** Provide to the Independent Auditors an ACFR audit final letter and a State-Level Single Audit updated final letter on behalf of OGC and Commonwealth management, specifying pertinent litigation, claims, and assessments in which OGC directly represents the agency or Commonwealth as well as matters included in agency responses.

7. PROCEDURES.

- a. Independent Auditors.** Transmit LAI request for summary of litigation, claims, and assessments to the DSCO and BAFM.

- b. BAFM.**
 - (1) Prepares documentation to be included in the LAI package and forwards the LAI package to OGC.
 - (2) Coordinates preparation of the LAI package with OGC to ensure all deadlines are met.
- c. OGC.** Prepares and transmits LAI package to agency counsel for completion. Both ACFR and State-Level Single Audit LAI packages are distributed to counsel for all agencies in the Commonwealth Financial Reporting Entity.
- d. DGS, Bureau of Finance and Risk Management.** Distributes listings of pending tort claims (and reserve allocations), for review and analysis. Agency specific listings are transmitted to agency counsel and a summary listing of tort claims affecting all agencies is distributed to the OAG.
- e. Agency Counsel.**
 - (1) Prepares, on behalf of the agency head, requests to the OAG and outside counsel providing legal representation for the agency for current information concerning litigation, claims, and assessments, other than tort claims under the *Sovereign Immunity Act, 42 Pa.C.S. §§ 8521-8528*. Requests OAG and outside counsel document such information in formal written preliminary, final, and updated final responses to the agency counsel.
 - (2) Reviews and approves or adjusts the listing of pending tort claims and reserve allocations.
 - (3) Responds to DGS with adjustments, as necessary.
- f. OAG.**
 - (1) Performs research and analyses to determine general litigation, claims, and assessments in which the OAG is directly representing an agency.
 - (2) Performs research and analyses to determine litigation, claims, and assessments that are not agency-specific but relate to the Commonwealth in general.
 - (3) Reviews and approves or adjusts the listing of pending tort claims and reserve allocations.
 - (4) Prepares and issues preliminary, final, and updated final responses to agency counsel requests that disclose the results of research and analyses performed in accordance with section 7.f.(1) of this directive.

NOTE: The OAG's preliminary, final, and updated final responses to the agency counsel for DGS shall include applicable tort information reviewed in accordance with Section 7.f.(3) of this directive (in addition to agency-specific information determined in accordance with Section 7.f.(1) of this directive).

- (5) Prepares and issues preliminary, final, and updated final responses to OGC's request regarding litigation, claims, and assessments that are not agency-specific and not included in accordance with Section 7.f.(4) of this directive.
- g. Agency Counsel.** Performs research and analyses to determine status of agency litigation, claims, and assessments, including those cases being administered by outside counsel and the OAG on behalf of the agency. Tort actions against the Commonwealth, pursuant to the *Sovereign Immunity Act, 42 Pa.C.S. §§ 8521-8528*, are to be addressed only by the agency counsel for DGS and the OAG; however, other civil actions, such as those related to the Employee Liability Self Insurance Program (ELSIP), shall be addressed by all agency counsel as agency-specific cases.
- h. DGS.**
 - (1) Adjusts listing of tort actions against the Commonwealth based on comments received from agency counsel and the OAG.
 - (2) Incorporates summary listings of tort actions affecting all agencies in preliminary, final, and updated final agency responses to OGC.
- i. Agency Counsel.**
 - (1) Completes preliminary, final, and updated final agency responses to OGC's LAI based on research and analyses performed in accordance with Sections 7.e. and 7.g. of this directive.
 - (2) Summarizes information provided by outside counsel and the OAG in preliminary, final, and updated final agency responses.
 - (3) Transmits preliminary, final, and updated final agency responses to LAI to OGC, with copies to agency heads.
- j. Agency Head.** Reviews preliminary, final, and updated final agency responses to OGC's LAI to ensure completeness.
- k. OGC.**
 - (1) Reviews preliminary, final, and updated final agency responses to LAI to ensure accuracy, completeness, and timeliness.
 - (2) Performs research and analyses to determine litigation, claims, and assessments where OGC directly represents the agency or the Commonwealth.
 - (3) Maintains copies and forwards originals of preliminary, final, and updated final agency responses to the Independent Auditors, with copies to BAFM.
- l. OGC and BAFM.** Reviews and summarizes preliminary, final, and updated final agency responses.

m. OGC.

- (1)** Adds any additional information concerning litigation, claims, and assessments not disclosed in agency responses to final summary of responses.
- (2)** Prepares final and updated final letters specifying pertinent litigation, claims, and assessments in which OGC directly represents the agency or the Commonwealth and which are not included in preliminary, final, and updated final agency responses.
- (3)** Transmits final and updated final letters to the Independent Auditors and BAFM with final summaries of responses, confirming that information concerning all litigation, claims, and assessments for all agencies and programs within the scope of the audit have been included in the final summaries.

This directive replaces, in its entirety, Management Directive 325.02 Amended, dated December 17, 2014.