

The Honorable Linda D. Thompson, Mayor  
and Honorable Members of City Council  
City of Harrisburg, Pennsylvania

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Harrisburg (City) as of and for the year ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America.

We reported on internal controls and their operation to the management of the City in the Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards* dated May 10, 2013, and in the Independent Auditor's Report on Compliance with Requirements that Could Have a Direct and Material Effect on Each Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133 dated May 10, 2013. However, during our audit, we noted certain matters involving internal controls and other operational matters that are presented in the attached memorandum for your consideration. This letter does not affect our report dated May 10, 2013 on the financial statements of the City.

The City's responses to the other matters identified in our audit are described in the attached memorandum. We did not audit the City's responses and, accordingly, we express no opinion on them.

This communication is intended solely for the information and use of the audit committee, management, the Honorable Mayor, Members of City Council, and others within the City and is not intended to be and should not be used by anyone other than these specified parties.

*Maher Duessel*

Harrisburg, Pennsylvania  
May 10, 2013

## **PROCESSING OF CASH RECEIPTS**

As noted in the December 31, 2010 audit, it is the City's procedure that all cash and checks received by the Treasurer's Office (including receipts received by other City departments and subsequently sent to Treasury) are deposited into the Central Depository Account. It is also the City's procedure that all money received by Treasury is immediately recorded and deposited in the bank the same day. The only exception to this procedure is the receipt of mercantile taxes. Treasury receives weekly collections of mercantile taxes, which may take several days to process and record.

During our discussions with various department personnel, it was noted that receipts are not being processed and recorded timely and, as a result, untimely and inaccurate bills are being sent to various City customers. We recommend that all cash receipts be processed and recorded in accordance with the City's procedures so as to ensure accurate and timely billing of City customers and to maximize cash flow.

**Management's Response:** The City concurs with the auditor's comments and recommendation. The City Treasurer's Office will endeavor to process, deposit and record all receipts in accordance with established procedures, pursuant to the auditor's recommendations.

## **RECORDING DEBIT/CREDIT TRANSFERS FOR UTILITY RECEIVABLES**

As noted in the December 31, 2010 audit, prior to January 1, 2009, the City applied utility payments to a customer's account based on sequential priority of payment (water, ready to serve, sewer, sanitation, disposal, etc.). As such, at certain times, a credit balance could exist in any given utility category. The City's Bureau of Information Technology (IT) created a program that runs each night to transfer credit balances from one utility category to the other utility categories. This transfer has been made in the utility billing system (DREV system); however, the associated cash has not been transferred to the various funds. An audit entry was proposed to record balances due to and due from the various utility funds to correct these amounts through 2010. Due to the change in priority of payments, the transfers for credit balance for the year ended December 31, 2011 were considered immaterial and no audit adjustment has been proposed. However, we recommend that the City review the subsequent debit/credit transfer reports and make the appropriate cash transfers. Further, we recommend that the City establish policies to review these debit/credit transfer reports periodically and make the necessary cash transfers.

**Management's Response:** The City agrees with the auditor's comments and recommendations. The City has established policy and procedures to review these debit/credit transfer reports, and has made and implemented the necessary programming changes to automate the cash transfers daily. Additionally, the City will make the prior period cash transfers identified and adjusted for.

## **RECORDING PAYMENTS ON DISPUTED ACCOUNTS**

As noted in the December 31, 2010 audit, in 2009, the City's disposal rates were increased significantly. Several of the City's commercial customers disputed the rates and formed a coalition. Once the coalition was formed and the City received notification of the dispute, these accounts were "flagged" in the utility billing system. Once an account was noted as "flagged" in the billing system, no payments could be applied to the disposal category of the customer's bill. The customers continued to be billed at the increased rates. Some customers paid the full amount while others paid the full amount less the disputed disposal charges. For those that paid the full amount, rather than placing the excess payments in an

escrow account, the excess disposal charges that could not be applied to the flagged disposal category were applied to the other utility categories (water, ready to serve, sewer, sewer maintenance, and sanitation), thereby creating credit balances in these utilities. During the 2010 audit and again during the 2011 audit, audit entries were proposed to record balances due to and due from the various utility funds to correct these amounts through 2010 and 2011. We recommend that the City review subsequent disputed account reports and make the appropriate transfers. Further, we recommend that the City create an escrow account for all amounts received from disputed customers related to the disposal category until these accounts can be settled.

**Management's Response:** The City concurs with the auditor's comments and recommendations. The City and The Harrisburg Authority (THA) have since reviewed the subsequent disputed account reports, and appropriate transfers have begun to be made. Further, the City is considering creating an escrow account for all amounts received from disputed customers related to the Disposal category until these accounts can be settled.

## **RECORDING MORTGAGE NOTES ON DEPARTMENT OF BUILDING AND HOUSING LOANS AND/OR GRANTS**

As noted in the December 31, 2010 audit, the City, through its Home Improvement Program (HIP), provides loans and/or grants for the rehabilitation of homes owned and occupied by low and moderate income homeowners. These loans/grants are used for repairs related to code violations or repairs or updates to major home systems. To qualify for assistance under the HIP, homeowners must meet various income, debt, and insurance requirements and must also sign a mortgage note at the time of settlement, regardless of whether the funding is for a loan or a grant. The homeowner has the option to repay the loan over a five- or ten-year term at an interest rate of 3%. The mortgage note is recorded in the Recorder of Deeds Office and gives the City legal claim as a second lien holder in the event of default on the loan or sale of the property prior to the five- or ten-year term of the loan/grant. During the audit, we noted that no mortgage note was signed by the homeowner or filed with the Recorder of Deeds for the 23 grants issued in 2010 or the 17 grants issued in 2011. We recommend that the City follow its policy for preparing and filing of the mortgage note for each loan/grant issued.

**Management's Response:** The City agrees with the auditor's comments and recommendation. Going forward, the City Solicitor and the Department of Building and Housing Development (DBHD) staff will follow their policy for preparing and filing of the mortgage note with the Recorder of Deeds for each loan/grant issued. Additionally, in late 2012, DBHD staff compiled a contact list for the loans/grants issued in 2010 and 2011, along with appropriate loan/grant closing files and mortgage notes to be executed, and began sending them to the homeowners.

## **MAINTAINING MONTHLY Q AND S ACCOUNT RECEIPTS REPORTS**

As noted in the December 31, 2010 audit, all receipts from Q and S accounts are processed through Treasury. Each month, a receipt summary of the Q and S receipts is provided to Operations and Revenue to be used to update the Q and S accounts spreadsheets (subsidiary ledger). During the audit, we noted that the receipt summary for June 2011 did not reflect a \$97,467 receipt from The Harrisburg Authority. We recommend that Treasury reflect all receipts from Q and S accounts on the receipt summary prior to the summary being forwarded to Operations and Revenue. Proper reporting by Treasury will provide the necessary information for Operations and Revenue to invoice Q and S accounts properly.

**Management's Response:** The City concurs with the auditor's comments and recommendation. The Administration's Bureau of Operations and Revenue will work with the City Treasurer's Office to ensure that monthly summaries of the Q and S account receipts are prepared and maintained prior to being forwarded to the Bureau of Operations and Revenue.

### **ACCOUNTING FOR ANCILLARY COSTS ASSOCIATED WITH CAPITAL ASSETS CONSTRUCTED BY THE CITY**

As noted in the December 31, 2010 audit, Governmental Accounting Standards Board (GASB) Statement No. 34 requires that the City track all capital assets, including infrastructure assets (roads, bridges, traffic signals, etc.). In addition to the hard cost of materials used for the construction of capital assets, the City is to capitalize any internal costs necessary to place the capital asset into its intended use. Therefore, should the City construct capital assets, the cost of labor, benefits, etc., should be included in the capitalized cost of the capital asset. We recommend that the City develop a policy to assist in capturing the ancillary costs for all capital assets constructed or put into place by the City.

**Management's Response:** The City agrees with the auditor's comments and recommendation. With the recent filling of the long-standing Senior Accountant and Accounting Manager vacancies in November 2012, the Administration can now undertake the development of a policy and procedures to assist in capturing the ancillary costs for all capital assets constructed or put into use by the City, pursuant to the auditor's recommendation.

### **INVENTORYING CAPITAL ASSETS**

As noted in the December 31, 2010 audit, no physical inventory has been taken since 2005. In that year, the accounting department provided each department head with a list of capital assets for their department. The department heads were to review the list for any obsolete assets or assets that were disposed. Further, when infrastructure capital assets are replaced, the replaced assets are not being removed from the capital asset inventory unless the department head completes a disposal form.

We recommend that the City inventory its capital assets on an annual basis so that disposals and additions are properly accounted for. The capital assets per the books should reconcile to the inventory of capital assets held by the City's departments. Additionally, the capital asset inventory should periodically be compared to insurance policies, to verify the completeness of the inventory.

**Management's Response:** The City concurs with the auditor's comments and recommendation. The City has been without an Assets/Grants Management Accountant for years due to the position being abolished. Going forward, the City will inventory its capital assets periodically so that additions, transfers, and disposals are properly accounted for, now that the vacant Senior Accountant and Accounting Manager positions have been filled in November 2012.

### **REVIEWING COMPENSATED ABSENCES**

As noted in the December 31, 2010 audit, the carryover and "advanced" balances are entered into the payroll system for each employee by IT. The advanced amounts, for the majority of the employees, are populated by the system (calculated based on their seniority date (hire date)) and a twelve-month table allows the system to calculate the advanced leave when an employee moves from one years-of-service

bracket to another during the current year. (e.g., if the years-of-service brackets change from 10 – 11 years of service and an employee will reach the 11 years of service in the current year).

However, there is no review of the carryover or “advanced” amounts by the timekeeper or the department heads. We recommend that the department head or the timekeeper review the carryover and advanced amounts at the beginning of the year to determine that the correct amounts have been made available to each employee.

**Management’s Response:** The City agrees with the auditor’s comments and recommendation. The Bureau of Human Resources coordinated this notification process with IT and the timekeepers in April 2013 to be effective January 1, 2013, to verify that the correct amounts have been made available to each employee, per the auditor’s recommendation.

## **COMPLYING WITH DEBT COVENANTS**

As noted in the December 31, 2010 audit, the City’s debt covenants require the City to provide certain financial information, including audited financial statements and operating data relating to the City no later than 270 or 180 days after the end of each fiscal year, depending upon the particular covenant. The City’s debt covenants also require the City to provide the electronic municipal market access system (EMMA) and the appropriate information depository in Pennsylvania (SID), annual audited general purpose financial statements presented in conformity with accounting principles generally accepted in the United States of America. Such financial statements must be provided within 270 days after the end of the fiscal year. We recommend that the City make every effort to complete the audited financial statements within the time requirements of the various debt covenants.

**Management’s Response:** By way of background, the City’s Finance Director/Accounting Manager of 13 years resigned his post in December 2009 to take a position with the incoming City Controller in January 2010. There was no one on staff within the Bureau of Financial Management with expertise and sufficient skill set to take his place. Thereafter in 2010, City Council eliminated funding for the Chief of Staff position, consolidating that position’s responsibilities into the new Chief of Staff/Business Administrator (BA) position. The Interim BA’s position was vacated in April 2010, and the Chief of Staff/Business Administrator resigned in July 2010. The Chief of Staff/BA position remained vacant until April 2012, so the newly hired Finance Director assumed all three position’s responsibilities, making it difficult to oversee City-wide operations and at the same time meet the City’s accounting and financial reporting disclosure obligations in a timely manner.

With the assistance of legal counsel, the City has since enhanced its disclosure process by drafting a formal written policy and has implemented related procedures with respect to public statements made by the City regarding financial information, and its compliance with its Continuing Disclosure Certificates.

Since March 2011, the City has complied with all known continuing disclosure requirements having to do with notifying all stakeholders, through EMMA, of published Material Event Notices for not being able to honor THA Resource Recovery Facility debt payment guarantee obligations and City general obligation debt payments as they came due, or Notices for Failure to Provide Required Annual Financial Information when due.

Through financial support provided to the City by the Commonwealth of Pennsylvania Department of Community and Economic Development under provisions of Act 47, public accounting firms were hired

in 2011, 2012, and 2013 to address the City's severe professional staffing capacity issue by assisting the City in preparing for its 2009, 2010, 2011, and 2012 annual Audits. Additionally, long-standing vacancies in the Senior Accountant and Accounting Manager positions were filled in November 2012. Due to the combination of these positive actions, the City anticipates being in full compliance with its annual reporting requirements under all debt covenants by mid-to-late 2013 with the culmination of the issuance of the City's 2012 Audit and related documents.

### **DEVELOPING FORMAL PROGRAM AND SYSTEM CHANGE CONTROL POLICIES AND PROCEDURES**

As noted in the December 31, 2010 audit, IT performs program development, operating system maintenance, and application software maintenance on the City's information technology systems. IT management maintains close oversight over the change control process, but more formalized documentation is recommended to reduce the risk of unauthorized changes being made to the City's information technology systems. The risk of unauthorized changes being made to information technology systems and programs could result in processing errors and system down-time. We recommend that a comprehensive written policy be developed that outlines all the procedures and documentation required for changes to the City's information technology systems and programs. The policy should follow the system development life cycle methodology to include the following:

- Preparation of written requests.
- Approval of the request by management.
- Required documentation standards.
- Testing of the changes, follow-up of discrepancies, and participation and approval by users.
- Procedures for integrating the changes into the production environment from a separate test environment.

**Management's Response:** The City agrees with the auditor's comments and recommendation. With the hiring of the long-vacant Network Administrator position in November 2012, the Bureau of IT will endeavor to develop and implement a comprehensive written policy per the auditor's recommendation.

### **DEVELOPING A POLICY FOR MONITORING NETWORK ACTIVITY**

As noted in the December 31, 2010 audit, IT is responsible for monitoring network activity and responding to potentially suspicious activity occurring within the network. There is currently no Intrusion Detection System that would allow monitoring of both internal and external traffic on a real-time basis. IT would not know if the network is being used maliciously until after a security breach has occurred. We recommend that an Intrusion Detection System be installed to monitor network activity.

**Management's Response:** The City concurs with the auditor's comments and recommendation. The Bureau of IT will look into the acquisition and installation of an Intrusion Detection System as recommended by the auditors as funding and other priorities allow.

### **PROVIDING COMPUTER EMPLOYEE TRAINING**

As noted in the December 31, 2010 audit, IT currently has 7 employees. There is currently limited training scheduled. It is extremely important for IT staff to be trained on the hardware and software

changes occurring in the City's computer environment. If the IT staff is not trained properly, this could result in vulnerabilities, poor employee performance, and down-time. We recommend that a training schedule be established for all IT staff as the budget permits.

**Management's Response:** The City agrees with the auditor's comments and recommendation. IT will look into free training opportunities for its staff, and other training as funding and other priorities allow.

## **DEVELOPING A TECHNOLOGY DISASTER RECOVERY PLAN - NETWORK SERVERS**

As noted in the December 31, 2010 audit, an information technology disaster recovery plan describes the procedures necessary to recover from an abnormal disruption in computerized operations. The objectives of disaster recovery are: to ensure that the City's information technology personnel are sufficiently prepared and trained in the event of a disaster; to minimize the effects upon the City's other operations; and to establish an alternate means of restoring normal information technology operations within a short period of time. The scope of a disaster recovery plan should cover the following issues:

- Identification of critical information technology systems relevant to the daily operations of the City
- An assessment of the vulnerability and security of each critical information technology system
- Disaster declaration and notification procedures and assignment of responsibilities to personnel
- Procedures for restoration of critical information technology systems
- Back-up and storage procedures for critical information technology systems
- Any required testing of the plan's disaster recovery procedures to ensure that the plan will function as intended
- An inventory of all critical information technology assets
- A list of employee and vendor contacts

There is no written disaster recovery plan for the City's network servers. In addition, although a written disaster recovery plan exists for the City's mainframe computer systems, the plan has not been tested since November 2009. We recommend that the City prepare a written disaster recovery plan that covers the network servers under the City's control and that the plan for both systems be tested periodically.

**Management's Response:** The City concurs with the auditor's comments and recommendations. Due to the City's severe financial distressed status under provisions of Act 47, the original Act 47 Coordinator's Financial Recovery Plan filed in 2011 called for the City to discontinue its contract with its Mainframe disaster recovery services provider and related off-site back-up and storage arrangements until further notice, so funding allocated in the 2011 Budget for this purpose was not utilized. Consequently, no funding was requested nor provided for the Information Technology Network subsequent to 2011. However, IT staff will endeavor to identify and implement certain aspects of an information technology disaster recovery plan that they have the capability to do as other priorities allow.

## **FOLLOWING PROPER APPROVAL PROCESS FOR ALL REQUISITIONS**

As noted in the December 31, 2010 audit, the City has a multi-level approval process for all requisitions over \$1,000. The requisition must be approved by the Budget Officer, the Department Head, the Business Administrator/Chief of Staff, the Purchasing Manager, and the Controller's Office before conversion to

an approved purchase order. For public bid contracts, it has been the City's policy to forego the budgetary, department head, and Controller's office approval of the requisition and have the Purchasing Manager enter a "blanket" approval code instead, thus creating an approved purchase order. The approved purchase order is then approved by the Controller's Office via approval of the manual purchase order and review of the contract. In addition, "old" approval codes that were created during the general ledger system conversion in 1999 still exist within the system. These "old" codes could be inadvertently used to create or approve a requisition. We recommend that the City follow its five-step approval process for all expenditures of the City and that the "old" approval codes be made inactive to avoid misuse.

**Management's Response:** The City agrees with the auditor's comments and recommendation. The Bureaus of Financial Management and IT will endeavor to review these approval procedures and system approval codes and make changes where necessary, per the auditor's recommendation.

### **ESTABLISHING A SYSTEM FOR ADMINISTRATIVE SERVICE CHARGES**

As noted in the December 31, 2010 audit, through the annual budget process, the City establishes administrative service charges that are paid by the Community Development Block Grant (CDBG) and utility funds (sewer, sanitation, water) to the City's General Fund. We recommend that the City establish a system to document support for the amount of administrative service charge being paid by each fund and reconcile the amounts with actual expenditures, annually.

**Management's Response:** The City concurs with the auditor's comments and recommendation. Beginning with 2012, the City Receiver instructed that these annual administrative service charges be limited to the amounts determined as indicated in the City's most recent Indirect Cost Allocation Plan. The City has complied with the Receiver's instructions.

### **UPDATING FEDERAL REPORTS TO REFLECT ACCOUNTABLE STAFF**

As noted in the December 31, 2010 audit, federal grant reports submitted by the City should reflect current City employees that control oversight of federal funding programs. During our testing of federal reporting, we noted the first and second quarter and annual reports within the Homelessness Prevention and Rapid Re-Housing Program (HPRP) were submitted to the U.S. Department of Housing and Urban Development using the name of the former Deputy Director for Housing as either preparer or program contact for the City. We recommend that the City update online reporting account information in order to accurately show the individual responsible for submission and oversight of the program.

**Management's Response:** The City agrees with the auditor's comments and recommendation. The DBHD Director and Deputy Director for Housing have established procedures to ensure that report preparer or program contact information is updated on-line on an on-going basis.

### **IMPLEMENTING STANDARDS AND INTERPRETATIONS OF THE GASB**

#### ***GASB STATEMENT NO. 60, "ACCOUNTING AND FINANCIAL REPORTING FOR SERVICE CONCESSION ARRANGEMENTS"***

The objective of this Statement is to improve financial reporting by addressing issues related to service concession arrangements (SCAs), which are a type of public-private or public-public partnership. As used in this Statement, an SCA is an arrangement between a transferor (a government) and an operator

(governmental or nongovernmental entity) in which (1) the transferor conveys to an operator the right and related obligation to provide services through the use of infrastructure or another public asset (a “facility”) in exchange for significant consideration and (2) the operator collects and is compensated by fees from third parties.

This Statement applies only to those arrangements in which specific criteria determining whether a transferor has control over the facility are met. A transferor reports the facility subject to an SCA as its capital asset, generally following existing measurement, recognition, and disclosure guidance for capital assets. New facilities constructed or acquired by the operator or improvements to existing facilities made by the operator are reported at fair value by the transferor. A liability is recognized, for the present value of significant contractual obligations to sacrifice financial resources imposed on the transferor, along with a corresponding deferred inflow of resources. Revenue is recognized by the transferor in a systematic and rational manner over the term of the arrangement.

This Statement also provides guidance for governments that are operators in an SCA. The governmental operator reports an intangible asset at cost for its right to access the facility and collect third-party fees; it amortizes the intangible asset over the term of the arrangement in a systematic and rational manner. For existing facilities, a governmental operator’s cost may be the amount of an up-front payment or the present value of installment payments. For new or improved facilities, a governmental operator’s cost may be its cost of improving an existing facility or constructing or acquiring a new facility.

For revenue sharing arrangements, this Statement requires governmental operators to report all revenues and expenses. A transferor reports its portion of the shared revenues.

This Statement requires disclosures about an SCA including a general description of the arrangement and information about the associated assets, liabilities, and deferred inflows, the rights granted and retained, and guarantees and commitments.

The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2011. The provisions of this Statement generally are required to be applied retroactively for all periods presented.

**GASB STATEMENT NO. 61, “THE FINANCIAL REPORTING ENTITY: OMNIBUS – AN AMENDMENT TO GASB STATEMENTS NO. 14 AND NO. 34”**

The objective of this Statement is to improve financial reporting for a governmental financial reporting entity. The requirements of Statement No. 14, “*The Financial Reporting Entity*,” and the related financial reporting requirements of Statement No. 34, “*Basic Financial Statements - and Management’s Discussion and Analysis - for State and Local Governments*,” were amended to better meet user needs and to address reporting entity issues that have arisen since the issuance of those Statements.

This Statement modifies certain requirements for inclusion of component units in the financial reporting entity. For organizations that previously were required to be included as component units by meeting the fiscal dependency criterion, a financial benefit or burden relationship also would need to be present between the primary government and that organization for it to be included in the reporting entity as a component unit. Further, for organizations that do not meet the financial accountability criteria for inclusion as component units but that, nevertheless, should be included because the primary government’s management determines that it would be misleading to exclude them, this Statement clarifies the manner

in which that determination should be made and the types of relationships that generally should be considered in making the determination.

This Statement also amends the criteria for reporting component units as if they were part of the primary government (that is, blending) in certain circumstances. For component units that currently are blended based on the “substantively the same governing body” criterion, it additionally requires that (1) the primary government and the component unit have a financial benefit or burden relationship or (2) management (below the level of the elected officials) of the primary government have operational responsibility for the activities of the component unit. New criteria also are added to require blending of component units whose total debt outstanding is expected to be repaid entirely or almost entirely with resources of the primary government. The blending provisions are amended to clarify that funds of a blended component unit have the same financial reporting requirements as a fund of the primary government. Lastly, additional reporting guidance is provided for blending a component unit if the primary government is a business-type activity that uses a single column presentation for financial reporting.

This Statement also clarifies the reporting of equity interests in legally separate organizations. It requires a primary government to report its equity interest in a component unit as an asset.

The provisions of the Statement are effective for financial statements for periods beginning after June 15, 2012. Earlier application is encouraged.

***GASB STATEMENT NO. 63, “FINANCIAL REPORTING OF DEFERRED OUTFLOWS OF RESOURCES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION”***

This Statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. Concepts Statement No. 4, “*Elements of Financial Statements*,” introduced and defined those elements as a consumption of net assets by the government that is applicable to a future reporting period, and an acquisition of net assets by the government that is applicable to a future reporting period, respectively. Previous financial reporting standards do not include guidance for reporting those financial statement elements, which are distinct from assets and liabilities.

Concepts Statement No. 4 also identifies net position as the residual of all other elements presented in a statement of financial position. This Statement amends the net asset reporting requirements in GASB Statement No. 34, “*Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*,” and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets.

The requirements of this Statement will improve financial reporting by standardizing the presentation of deferred outflows of resources and their effects on a government’s net position. It alleviates uncertainty about reporting those financial statement elements by providing guidance where none previously existed.

The provisions of the Statement are effective for financial statements for periods beginning after December 15, 2011. Earlier application is encouraged.

**GASB STATEMENT NO. 64, “DERIVATIVE INSTRUMENTS; APPLICATION OF HEDGE ACCOUNTING TERMINATION PROVISIONS – AN AMENDMENT OF GASB STATEMENT NO. 53”**

Some governments have entered into interest rate swap agreements and commodity swap agreements in which a swap counterparty, or the swap counterparty’s credit support provider, commits or experiences either an act of default or a termination event as both are described in the swap agreement. Many of those governments have replaced their swap counterparty, or swap counterparty’s credit support providers, either by amending existing swap agreements or by entering into new swap agreements. When these swap agreements have been reported as hedging instruments, questions have arisen regarding the application of the termination of hedge accounting provisions in Statement No. 53, “*Accounting and Financial Reporting for Derivative Instruments.*” Those provisions require a government to cease hedge accounting upon the termination of the hedging derivative instrument, resulting in the immediate recognition of the deferred outflows of resources or deferred inflows of resources as a component of investment income.

The objective of this Statement is to clarify whether an effective hedging relationship continues after the replacement of a swap counterparty or a swap counterparty’s credit support provider. This Statement sets forth criteria that establish when the effective hedging relationship continues and hedge accounting should continue to be applied.

The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2011. Earlier application is encouraged.

**GASB STATEMENT NO. 65, “ITEMS PREVIOUSLY REPORTED AS ASSETS AND LIABILITIES”**

This Statement clarifies the appropriate reporting of deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting.

Concepts Statement No. 4, “*Elements of Financial Statements,*” specifies that recognition of deferred outflows and deferred inflows should be limited to those instances specifically identified in authoritative GASB pronouncements. Consequently, guidance was needed to determine which balances being reported as assets and liabilities should actually be reported as deferred outflows of resources or deferred inflows of resources, according to the definitions in Concepts Statement 4. Based on those definitions, this Statement reclassifies certain items currently being reported as assets and liabilities as deferred outflows of resources and deferred inflows of resources. In addition, this Statement recognizes certain items currently being reported as assets and liabilities as outflows of resources and inflows of resources.

The provisions of the Statement are effective for financial statements for periods beginning after December 15, 2012. Earlier application is encouraged.

**GASB STATEMENT NO. 66, “TECHNICAL CORRECTIONS – 2012 – AN AMENDMENT OF GASB STATEMENTS NO 10. AND NO. 62”**

The objective of this Statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, “*Fund Balance Reporting and Governmental Fund Type*

*Definitions,*” and No. 62, “*Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements.*”

This Statement amends Statement No. 10, “*Accounting and Financial Reporting for Risk Financing and Related Insurance Issues,*” by removing the provision that limits fund-based reporting of an entity’s risk financing activities to the general fund and the internal service fund type. As a result, governments should base their decisions about fund type classification on the nature of the activity to be reported, as required in Statement No. 54 and Statement No. 34, “*Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments.*”

This Statement also amends Statement No. 62 by modifying the specific guidance on accounting for (1) operating lease payments that vary from a straight-line basis, (2) the difference between the initial investment (purchase price) and the principal amount of a purchased loan or group of loans, and (3) servicing fees related to mortgage loans that are sold when the stated service fee rate differs significantly from a current (normal) servicing fee rate. These changes clarify how to apply Statement No. 13, “*Accounting for Operating Leases with Scheduled Rent Increases,*” and result in guidance that is consistent with the requirements in Statement No. 48, “*Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues,*” respectively.

The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012. Earlier application is encouraged.

## ***GASB STATEMENTS NO. 67 AND 68, “FINANCIAL REPORTING FOR PENSION PLANS” AND “ACCOUNTING AND FINANCIAL REPORTING FOR PENSIONS”***

These Statements revise and establish new financial reporting requirements for most governments that provide their employees with pension benefits.

Pension plans are distinguished for financial reporting purposes in two ways. First, plans are classified by whether the income or other benefits that the employee will receive at or after separation from employment are defined by the benefit terms (a defined benefit plan) or whether the pensions an employee will receive will depend only on the contributions to the employee’s account, actual earnings on investments of those contributions, and other factors (a defined contribution plan).

In addition, defined benefit plans are classified based on the number of governments participating in a particular pension plan and whether assets and obligations are shared among the participating governments. Categories include plans where only one employer participates (single employer); plans in which assets are pooled for investment purposes, but each employer’s share of the pooled assets is legally available to pay the benefits of only its employees (agent employer); and plans in which participating employers pool or share obligations to provide pensions to their employees and plan assets can be used to pay the benefits of employees of any participating employer (cost-sharing employer).

Statement No. 68 replaces the requirements of Statement No. 27, “*Accounting for Pensions by State and Local Governmental Employers,*” and Statement No. 50, “*Pension Disclosures,*” as they relate to governments that provide pensions through pension plans administered as trusts or similar arrangements that meet certain criteria. Statement No. 68 requires governments providing defined benefit pensions to recognize their long-term obligation for pension benefits as a liability for the first time, and to more comprehensively and comparably measure the annual costs of pension benefits. The Statement also

enhances accountability and transparency through revised and new note disclosures and required supplementary information (RSI).

**Defined Benefit Pension Plans.** The Statement requires governments that participate in defined benefit pension plans to report in their statement of net position a net pension liability. The net pension liability is the difference between the total pension liability (the present value of projected benefit payments to employees based on their past service) and the assets (mostly investments reported at fair value) set aside in a trust and restricted to paying benefits to current employees, retirees, and their beneficiaries.

The Statement calls for immediate recognition of more pension expense than is currently required. This includes immediate recognition of annual service cost and interest on the pension liability and immediate recognition of the effect on the net pension liability of changes in benefit terms. Other components of pension expense will be recognized over a closed period that is determined by the average remaining service period of the plan members (both current and former employees, including retirees). These other components include the effects on the net pension liability of (a) changes in economic and demographic assumptions used to project benefits and (b) differences between those assumptions and actual experience. Lastly, the effects on the net pension liability of differences between expected and actual investment returns will be recognized in pension expense over a closed five-year period.

Statement No. 68 requires cost-sharing employers to record a liability and expense equal to their proportionate share of the collective net pension liability and expense for the cost-sharing plan. The Statement also will improve the comparability and consistency of how governments calculate the pension liabilities and expense. These changes include:

- Projections of Benefit Payments.
- Discount Rate.
- Attribution Method.
- Note Disclosures and Required Supplementary Information.

Statement No. 67 (Plans) replaces the requirements of Statement No. 25, *“Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans,”* and Statement No. 50 as they relate to pension plans that are administered through trusts or similar arrangements meeting certain criteria. The Statement builds upon the existing framework for financial reports of defined benefit pension plans, which includes a statement of fiduciary net position (the amount held in a trust for paying retirement benefits) and a statement of changes in fiduciary net position. Statement No. 67 enhances note disclosures and RSI for both defined benefit and defined contribution pension plans. Statement No. 67 also requires the presentation of new information about annual money-weighted rates of return in the notes to financial statements and in 10-year RSI schedules.

The provisions in Statement No. 67 are effective for financial statements for periods beginning after June 15, 2013. The provisions in Statement No. 68 are effective for fiscal years beginning after June 15, 2014. Earlier application is encouraged for both Statements.

## **GASB STATEMENT NO. 69, “GOVERNMENT COMBINATIONS AND DISPOSALS OF GOVERNMENT OPERATIONS”**

This Statement establishes accounting and financial reporting standards related to government combinations and disposals of government operations. As used in this Statement, the term *government*

*combinations* includes a variety of transactions referred to as mergers, acquisitions, and transfers of operations.

The distinction between a government merger and a government acquisition is based upon whether an exchange of significant consideration is present within the combination transaction. Government mergers include combinations of legally separate entities without the exchange of significant consideration. This Statement requires the use of carrying values to measure the assets and liabilities in a government merger. Conversely, government acquisitions are transactions in which a government acquires another entity, or its operations, in exchange for significant consideration. This Statement requires measurements of assets acquired and liabilities assumed generally to be based upon their acquisition values. This Statement also provides guidance for transfers of operations that do not constitute entire legally separate entities and in which no significant consideration is exchanged. This Statement defines the term *operations* for purposes of determining the applicability of this Statement and requires the use of carrying values to measure the assets and liabilities in a transfer of operations.

A disposal of a government's operations results in the removal of specific activities of a government. This Statement provides accounting and financial reporting guidance for disposals of government operations that have been transferred or sold.

This Statement requires disclosures to be made about government combinations and disposals of government operations to enable financial statement users to evaluate the nature and financial effects of those transactions.

The requirements of this Statement are effective for government combinations and disposals of government operations occurring in financial reporting periods beginning after December 15, 2013, and should be applied on a prospective basis. Earlier application is encouraged.

### ***GASB STATEMENT NO. 70, "ACCOUNTING AND FINANCIAL REPORTING FOR NONEXCHANGE FINANCIAL GUARANTEES"***

Some governments extend financial guarantees for the obligations of another government, a not-for-profit entity, or a private entity without directly receiving equal or approximately equal value in exchange (a nonexchange transaction). As a part of this nonexchange financial guarantee, a government commits to indemnify the holder of the obligation if the entity that issued the obligation does not fulfill its payment requirements. Also, some governments issue obligations that are guaranteed by other entities in a nonexchange transaction. The objective of this Statement is to improve accounting and financial reporting by state and local governments that extend and receive nonexchange financial guarantees.

This Statement requires a government that extends a nonexchange financial guarantee to recognize a liability when qualitative factors and historical data, if any, indicate that it is more likely than not that the government will be required to make a payment on the guarantee. The amount of the liability to be recognized should be the discounted present value of the best estimate of the future outflows related to the guarantee expected to be incurred. When there is no best estimate but a range of the estimated future outflows can be established, the amount of the liability to be recognized should be the discounted present value of the minimum amount within the range.

This Statement requires a government that has issued an obligation guaranteed in a nonexchange transaction to recognize revenue to the extent of the reduction in its guaranteed liabilities. This Statement

also requires a government that is required to repay a guarantor for making a payment on a guaranteed obligation or legally assuming the guaranteed obligation to continue to recognize a liability until legally released as an obligor. When a government is released as an obligor, the government should recognize revenue as a result of being relieved of the obligation. This Statement also provides additional guidance for intra-entity nonexchange financial guarantees involving blended component units.

This Statement specifies the information required to be disclosed by governments that extend nonexchange financial guarantees. In addition, this Statement requires new information to be disclosed by governments that receive nonexchange financial guarantees.

The provisions of this Statement are effective for reporting periods beginning after June 15, 2013. Earlier application is encouraged. Except for disclosures related to cumulative amounts paid or received in relation to a financial guarantee, the provisions of this Statement are required to be applied retroactively. Disclosures related to cumulative amounts paid or received in relation to a financial guarantee may be applied prospectively.

**Management's Response:** The following pertains to the auditor's comments on planning for the implementation of GASB Statement Nos. 60, 61, 63, 64, 65, 66, 67, 68, 69, and 70. The City concurs that planning is a crucial element of successful implementation of these GASB Statements and will review the specific requirements of these new standards and their potential impact on the City of Harrisburg. The Bureau of Financial Management will continue to review and plan for these implementation requirements and monitor subsequent interpretations and guidance from the American Institute of Certified Public Accountants and Government Finance Officers Association.