

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

In planning and performing our audit of the financial statements of the City of Harrisburg (City) as of and for the year ended December 31, 2012, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

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 November 8, 2013 and in the Independent Auditor's Report on Compliance for Each Major Program and on Internal Control over Compliance Required by OMB Circular A-133 dated November 8, 2013. However, during our audit we became aware of several other matters that are opportunities for strengthening internal controls and operating efficiencies. The memorandum that accompanies this letter summarizes our comments and suggestions regarding these matters. This letter does not affect our report dated November 8, 2013 on the financial statements of the City.

The City's responses to the other matters identified in our audit have not been subject to the audit procedures applied in the audit of the financial statements 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
November 8, 2013

TIMELY DEPOSIT OF CASH RECEIPTS

The City has several departments where amounts are received directly from customers or outside entities. It is the City's policy that any receipts received at the departmental level be taken to Treasury on a daily basis for deposit. During the audit, we noted that an amount was received at the departmental level on December 2, 2012, but was not taken to Treasury and deposited until January 11, 2013. We recommend that the City follow its policy regarding daily transfer of receipts to Treasury.

Management's Response: The City will endeavor to follow its policy regarding daily transfer of receipts to Treasury as recommended by the auditors.

MAINTAINING PROPER DOCUMENTATION FOR DEBT SERVICE WIRE TRANSFERS

Supporting documentation for all disbursements made by the City, whether by check or wire transfer, is to be maintained by the Bureau of Financial Management. During the audit, we noted that the Bureau of Financial Management did not have supporting documentation for two wire transfers related to capital lease payments. We recommend that the City follow its policy for maintaining all documentation in the Bureau of Financial Management for all disbursements.

Management's Response: The Bureau of Financial Management will endeavor to strictly follow City policy for providing and maintaining documentation in support of all disbursements.

RECORDING PAYMENTS ON DISPUTED ACCOUNTS

As noted in the December 31, 2011 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.

During the year ended December 31, 2012, as a continuation of a process started by a former public works director, surveys were conducted for numerous disputed accounts. These surveys were performed by the City's public works and engineering department and were performed to determine the services that were needed and/or being provided to each disputed customer. In addition to completing a survey of services required by the customer, photographs of the site were also taken. Based on the responses to the surveys, the City determined the amounts each customer should be billed for disposal services. Beginning the month after the surveys were performed, the City removed the disputed flag from the system and began billing using the revised disposal charges per the survey. When the disputed flag was removed from the customer's account, two separate transactions occurred: 1) the account was removed from the disputed accounts listing and all debit and credit balances were removed from the disputed report; and 2)

the credit balances in the other utility categories were transferred and applied to the outstanding disposal balances when the nightly debit/credit transfer program was run.

The results of the survey efforts were a decrease in the number of disputed accounts from 47 at December 31, 2011 to 24 at December 31, 2012. However, an audit entry was proposed to adjust the balances due to and due from the various utilities to correct the amounts for the remaining 24 accounts.

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 the remaining accounts can be settled.

Management's Response: The City concurs with the auditor's comments and recommendations. The City has since reviewed the subsequent disputed account reports, and appropriate cash transfers are being arranged. 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 DEBIT/CREDIT TRANSFERS FOR UTILITY RECEIVABLES

As noted in the December 31, 2011 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. During the year ended December 31, 2012, numerous disputed accounts were settled and the disputed account "flag" was removed. The credit balances associated with these disputed accounts were transferred from one utility category to the other utility categories in the DREV system only. The associated cash has not been transferred to the various funds. In November 2012, IT created a Treasury report that denotes the cash transfer to be made relative to the credit transfers that result from the nightly credit transfer program. As such, no additional due to or due from amounts will be recorded subsequent to November 2012. However, in order to accurately reflect the amounts due to and due from the various funds related to the credit transfers, an audit entry was proposed to record both the 2011 and 2012 amounts. We recommend that the City review the debit/credit transfer reports and make the appropriate 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 MORTGAGE NOTES ON DEPARTMENT OF BUILDING AND HOUSING LOANS AND/OR GRANTS

As noted in the December 31, 2011 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 18 grants issued in 2010, the 22 grants issued in 2011, or the 36 loans/grants in 2012. However, through early October 2013, 67 mortgages and note documents have since been signed by the homeowners and provided to Office of the City Solicitor for filing with the Dauphin County Recorder of Deeds. We recommend that the City follow its policy for preparing and filing of the mortgage note for each loan/grant when 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, the results of which are noted above.

MAINTAINING MONTHLY Q AND S ACCOUNT RECEIPTS REPORTS

As noted in the December 31, 2011 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 February, May, August, and November 2012 did not reflect all amounts received. In total, these four months did not include \$377,040 of receipts. 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, 2011 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. Once the Staff Accountant/Financial Analyst vacancy is filled, the Administration will be able to 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, 2011 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 once the Staff Accountant/Financial Analyst position has been filled.

REVIEWING COMPENSATED ABSENCES

As noted in the December 31, 2011 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 for certain departments. 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 have the department head and the timekeeper review the projected leave earnings for the "Year 2013" for each employee.

COMPLYING WITH DEBT COVENANTS

As noted in the December 31, 2011 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 adopting 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 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, 2011 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. The Bureau of IT will endeavor to develop and implement a comprehensive written policy once the newly vacant Network Administrator position is filled.

DEVELOPING A POLICY FOR MONITORING NETWORK ACTIVITY

As noted in the December 31, 2011 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, 2011 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 during the December 31, 2011 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. In addition, in January 2012, the City terminated its "Hot Site" contract which provided a disaster recovery site along with a set amount of time each year to test the mainframe recovery. Even though the contract was terminated, a recovery site is still available to the City but arrangements would need to be made to utilize the site each time an event occurs.

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, 2011 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: At the time the new Pentamation System was created, it was agreed by the Bureau of Financial Management and the Controller's Office that since public bids go through an intense approval process, i.e. specification approval, contract review and award recommendations from the Department Head and budget approval before the bid specifications are circulated, before the award is made and before the purchase order and contracts are circulated; it would move an already lengthy process along if the requisition would be entered by the Purchasing Office as "contracts". The Controller's Office, along with the Law Bureau, Business Administrator, and Mayor each sign off on the purchase order and contract. Though approvals are not done electronically, as are the "regular" requisitions, requisitions for purchase orders are approved by all parties concerned. Financial Management does not forego any approvals.

The Bureaus of Financial Management or IT cannot remove or delete old approval codes as there is history attached to the records. The Bureau of Financial Management will attempt to contract Pentamation to see if there is a program available for this function without destroying history.

COMPLYING WITH TERMS OF LEASE AGREEMENT

In accordance with Article 5 of the Second Supplemental Agreement of Lease as amended by the Third and Fourth Supplemental Agreement of Lease and the Collection System Lease between The Harrisburg Authority (Authority) and the City of Harrisburg, Pennsylvania (City), the Sewer Revenue Trust Fund is, at the end of each lease year, required to accumulate amounts in the Sewer Revenue accounts, after withdrawals for operating expense obligations, until the balance is such that the reserve shall equal the sum of (1) one-half of the lease rental due under the next lease year, and (2) one-half of the annual operating expenses as estimated by the consulting engineers, for the next succeeding lease year. Additionally, after the required reserve balance is attained, the City is required to pay any excess funds to The Harrisburg Authority within 190 days after the end of the year. For the year ended December 31, 2012, the accumulated reserve exceeded the required amount and the funds were not transferred to the Authority within 190 days. We recommend that the City comply with the requirements of the lease agreement and transfer the funds within the required timeframe.

Management's Response: Transfer of these funds is being considered in conjunction with the transfer of Sewer operations from the City to the Authority effective late 2013 pursuant to the Harrisburg Strong Plan.

IMPLEMENTING STANDARDS AND INTERPRETATIONS OF THE GOVERNMENTAL ACCOUNTING STANDARDS BOARD (GASB)

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. 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. 61, 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.