MaherDuessel

The Honorable
Eric R. Papenfuse, Mayor
and Honorable Members
of City Council
City of Harrisburg,
Pennsylvania

In planning and performing our audit 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, 2017, 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 September 25, 2018, and in the Independent Auditor's Report on Compliance for Each Major Program and on Internal Control over Compliance Required by the Uniform Guidance dated September 25, 2018. 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 September 25, 2018 on the financial statements of the City.

The City's written responses to the internal control issues identified in our audit have not been subjected to the audit procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

We have already discussed these comments and suggestions with various City personnel. We will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.

This communication is intended solely for the information and use of the Honorable Mayor, Members of City Council, the audit committee, management, 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
September 25, 2018

Accounting for Ancillary Costs Associated with Capital Assets Constructed by the City

As previously noted in the December 31, 2005 through December 31, 2016 audits, 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 concurs and will endeavor, as staffing resources allow, to develop and implement appropriate procedures needed to capture and capitalize such costs.

Inventorying Capital Assets

As previously noted in the December 31, 2007 through December 31, 2016 audits, 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.

In addition, the Accounting Manager is responsible for entering all capital asset additions into the Capital Assets System based on expenditures/expenses recorded in the capital expenditure accounts for the various funds. There is no review or reconciliation of the amounts entered into the Capital Asset System by anyone other than the Accounting Manager.

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. Finally, we recommend that someone other than the Accounting Manager review the information entered into the Capital Assets System for accuracy.

Management's Response: The City concurs and will endeavor, when staffing and resources allow, to develop and implement appropriate procedures in order to inventory its capital assets periodically, so that additions, transfers, and disposals are properly documented and accounted for. The City hopes to begin this process in 2017, using the Park Maintenance Bureau as a pilot program.

Developing Formal Program and System Change Control Policies and Procedures

As previously noted in the December 31, 2005 through December 31, 2016 audits, the Bureau of Information Technology (IT) performs program development, operating system maintenance, and application software maintenance on the City's IT 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 IT systems. The risk of unauthorized changes being made to information technology systems and programs could result in processing errors and system down-time. During our testing, we requested documentation supporting changes made to City's IT systems. This documentation could not be provided. We recommend that a comprehensive written policy be developed that outlines all the procedures and documentation required for changes to the City's IT 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.

We also recommend that documentation be maintained by the City to support any changes made to programs and systems. This documentation should include retention of all documents as noted above and should be maintained for each change made.

Management's Response: The City concurs with the recommendation and will implement a change control process. The process will include written requests from the owner and an approval process of the request by management. As part of the development process, documentation will be required, as well as a formal testing process, with follow-up for defects and discrepancies. The City will institute a deployment process, which will include the procedures for implementing in the production environment. The City anticipates that this can be done primarily with internal staff and support from vendors, where applicable. This will require support from our leaders to change the common process in use today. If external resources are required, approved budgetary funding will be needed. The City has begun an informal process for requested changes, by involving them in the requirements gathering and testing processes. Due to other priorities, the formal development of a process has been delayed. The City anticipates a plan will be completed and implemented by the end of the first quarter of 2019.

Developing a Policy for Monitoring Network Activity

As previously noted in the December 31, 2005 through December 31, 2016 audits, 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 recommendation. To mitigate the risk of malicious activity on our network, during 2018, the City implemented several new policies for all employees. These policies include an IT Password Policy, IT Acceptable Use Policy, Minimum Access Policy, and Mobile Device Management (MDM) Security Policy. In addition, a Data Breach Response Policy has been drafted, but not yet finalized. We anticipate that it will be completed by the end of the first quarter of 2019. The City is a member of the MS-ISAC (Multi-State Information Sharing and Analysis Center). It is an organization designed and funded by the Department of Homeland Security, to assist government entities with cyber threat prevention, protection, response, and recovery. There is no cost to the City. They provide 24x7 monitoring of cyber threats and alert members of new threats that they need to be aware of, and act upon, if necessary. During 2018, the City also implemented Microsoft's System Center Configuration Manager (SCCM) to assist with the management of computers, including remote control, patch management, software distribution, operating system deployment, network access protection, and hardware and software inventory. Additional analysis of tools and best practices will continue throughout the rest of 2018 and 2019. The purchase of tools will be dependent on the availability of funds.

Providing Computer Employee Training

As previously noted in the December 31, 2005 through December 31, 2016 audits, there is currently limited training scheduled for IT employees. 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 concurs with the recommendation. The City has evaluated the skills of the current staff members and identified several training areas that should be addressed. Both technical skills and soft skills have been identified. Options for training have been evaluated, including online, classroom, and internal knowledge transfer. The training assessment and recommendation document has been started and should be completed during the fourth quarter of 2018. As identified in the recommendation, the training schedule and implementation of the training plan will be dependent on the availability of funds in the budget.

Developing a Technology Disaster Recovery Plan – Network Servers

As previously noted in the December 31, 2010 through December 31, 2016 audits, 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 financially 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 offsite backup and storage arrangements until further notice. As such, funding allocated in the 2011 Budget for this purpose was not utilized. Consequently, no funding was requested, nor provided, for the Information Technology Network from 2011 through 2017.

The City plans to engage with external Data Center entities to provide redundancy of our existing Data Center. We are currently working with our IBM Mainframe maintenance vendor to install, test, and implement a virtual tape server that would allow us to backup all Mainframe systems and data to a Data Center in Denver, Colorado, for disaster recovery purposes. This arrangement could ultimately be expanded to include total redundancy of the Mainframe environment. We are also looking to engage with a local Data Center for providing disaster recovery and redundancy capabilities for our open systems environment. We anticipate that the offsite Mainframe backups will be completed by the end of 2018, with recovery testing to be conducted in the first quarter of 2019. We also anticipate that disaster recovery capabilities for the open systems environment to be completed by the end of the 2nd quarter of 2019. The implementation of these plans will depend on available funds within the budget.

Reviewing Physical and Logical Access Controls

The following issues were noted related to IT access controls:

- User accounts that grant physical access to the sever room were still active for individuals who are no longer employed by the City.
- A number of individuals who are no longer employed by the City still have active user accounts in the accounting system. Some of these user accounts have administrative access to the system. In addition, system access for several active user accounts could be further restricted to better match those employees' job duties.
- One individual, who separated from the City in the current year, had not been removed as a user account in the active directory system.

- Several individuals were inappropriately granted access to the network accounting drive.
- Documentation to support user access to the mainframe system was not readily available.

In order to mitigate the risk of unauthorized access to various systems and data, we recommend that a review of user access occur for the accounting, network, and mainframe systems, as well as the server room. In addition, a policy should be implemented requiring removal of user accounts from the network and applications when an individual separates from the City. Finally, we recommend that the City maintain documentation to support its IT systems.

Management's Response: The City recently implemented updated Onboarding / Offboarding procedures that will make it easier to control the appropriate access to the various systems deployed throughout the City. Periodic reviews of system access will be performed, to ensure that terminated employees are removed from systems in a timely manner. We are also in the process of documenting existing systems, to assist with providing a high level of support for these systems.

Restoring Backups Periodically

IT system backups are not periodically restored. To ensure that files are being properly backed up, we recommend that backups be periodically restored.

Management's Response: Since the end of 2011, the City has not been able to restore backups, because we did not have access to other equipment to be able to do so. Once the testing and implementation efforts for our Mainframe virtual tape server are complete, we will be able to do so for that platform. We anticipate being able to restore that environment in the first quarter of 2019. Once we have another Data Center entity in place for the open systems environment, we will be able to restore those systems and provide redundancy at that location.

Creating a Policy for Use of the Virtual Private Network (VPN)

Some City employees are provided access to the City's network and City applications on their home computers. The City does not require the use of an anti-malware system on these home computers. This increases the risk of a breach of network information. We recommend that the City formalize a policy requiring that each employee who accesses City information on a home computer have some form of anti-malware installed on the computer being used to access City information. This policy should be signed by each employee prior to access being granted to the system.

Management's Response: The City concurs with this recommendation. The City will work on developing a policy for employees who require VPN access from a home computer. The policy will include minimum requirements for the device, including anti-virus software, to ensure the security of the City data that is being access from that device. We anticipate that the policy should be developed and ready for implementation by the end of the first quarter or 2019.

Converting Vacation Carryover Balances for Firefighters

As previously noted in the December 31, 2014 through December 31, 2016 audits, based on the City's vacation policy for firefighters, at year-end, accrued vacation is to be converted to holiday pay. During our testing of compensated absences, it was noted that 17 firefighters had accrued vacation balances at December 31, 2017 that had not been converted to holiday time. In order to ensure that compensated absences are properly reflected for firefighters, we recommend that the City follow its policy as it relates to accrued vacation for firefighters.

Management's Response: In 2014, the vacation leave earning rates for new hires changed from 12 to 8 days, with the implementation of the amendments to the Collective Bargaining Agreement approved in late 2013. However, the leave system calculation program continued to credit the new hires with the prior earning rate. Upon discovering this error, the City was unable to convert the vacation carryover balances until IT was able to make adjustments to the program. Due to lack of appropriate IT staff with knowledge of the legacy business logic, the adjustments have not yet been completed. The City will include this system modification on its list of projects to consider in 2019, with the anticipation that it will be completed by the end of 2019, for the carryover of balances from 2019 to 2020.

Establishing Review Procedures for Sanitation and Disposal Billings and Customer Account Adjustments

During the year ended December 31, 2015, the City hired a Sanitation Billing and Enforcement Coordinator (Coordinator) to manage the billing functions for Sanitation and Disposal. Also during the year ended December 31, 2015, the City purchased new trash and recycling containers and distributed those containers to residential and commercial customers. Billings were changed to a per container basis and will vary based on the frequency of trash pick-up. The Coordinator is responsible for creating new customer accounts, maintaining documentation of the number of containers issued to each customer, updating customer accounts for any changes to the number of containers or the frequency of pick-up, and reviewing the monthly billings reports. Currently, there are no procedures in place for review of the tasks performed by the Coordinator. In addition, there are no procedures in place for follow-up on delinquent accounts. We recommend that procedures be implemented for review of the tasks performed by the Coordinator and that procedures be implemented to follow up on delinquent accounts.

Management's Response: The City concurs with this recommendation and will attempt to implement for future effectiveness.

Reconciling Shared Services Revenue and Expense and Invoicing Other Post-Employment Expenses for Water and Sewer Retirees

The City incurred certain revenues and expenditures under the Shared Service Agreement and the Transition Agreement with Capital Region Water (CRW). We noted the following items:

- Per the shared services agreement, within 60 days after the end of each term, the parties are required to reconcile the actual costs for providing services to CRW to the costs in the budget provided pursuant to the shared services schedule. The City and CRW are to then reduce or increase the payments for the services based on actual costs. The City and CRW continue to negotiate the actual costs related to these shared services for the years ended December 31, 2013 through 2016. No additional shared services costs were incurred during the year ended December 31, 2017.
- Per the transition agreement, CRW assumed responsibility for all costs for other post-employment benefit costs for Water and Sewer retirees. Costs are to be invoiced by the City to CRW on a monthly basis and paid within 30 days of receipt of the invoice. During our testing of other post-employment benefit costs, it was noted that the City invoiced CRW timely for other post-employment costs incurred during the year ended December 31, 2017; however, the invoices did not include all other post-employment costs incurred by the City and did not reflect pension withholding amounts that are used to offset these costs.

We recommend that the City review the Shared Services Agreement and Transition Agreement and ensure that all items in the agreements are being followed and invoiced appropriately.

Management's Response: The City will endeavor to implement suggest recommendations; however, in retrospect, the agreement was a hastily written and poorly articulated document which did not anticipate certain administrative, logistical, financial, and compliance realities of effectuation and its fundamental defects prevent the actualization of the deadlines as delineated.

Calculating the Minimum Municipal Obligation for the City of Harrisburg Police Pension Plan

The 2017 Minimum Municipal Obligation (MMO) for the Non-uniformed Employees', Firefighters', and Police pension plans is calculated based on 2016 projected payroll amounts. The 2016 projected payroll for the Police pension plan omitted police extra duty wages. The omission did not materially affect the amount of the MMO for the Police pension plan. In order to ensure that the MMO is calculated correctly, we recommend that the City implement procedures to ensure that all appropriate salaries and wages are included in the calculation.

Management's Response: The City concurs and has done so for its 2019 calculation. However, in all prior years the City has calculated its MMO without including extra duty wages - as they are not included in final pension benefit calculations - and it has never been raised as a concern. The City believes this issue needs further examination.

Obtaining Required Signatures on Manual Checks

As previously noted in the December 31, 2016 audit, the City maintains manual checkbooks for the Central Depository, Fire Escrow, and Payroll accounts. These checkbooks are in the custody of the Treasurer's Office. Currently, the Treasurer is the only signer for the Central Depository and Fire Escrow accounts. Per Section 1704(a) of the City Code, the City Controller is to countersign all documents authorizing payment of moneys out of the City treasury when satisfied of the legality of the payment. We recommend that the City comply with the City Code and add the Controller as an authorized signer on the Central Depository and Fire Escrow accounts, and that the Controller's office review, approve, and sign all checks written from these accounts.

Management's Response: The City has collectively discussed this recommendation among the Bureau of Financial Management, the Office of the City Treasurer, and the Office of the City Controller and will continue to consider such effective internal control.

Implementing Procurement Policies

As previously noted in the December 31, 2015 and 2016 audits, the Office of Management and Budget (OMB) has issued the Uniform Guidance, which includes a revision of procurement standards related to property and services charged to federal awards. The OMB is allowing a grace period of three fiscal years to implement the procurement standards. The City will be subject to the procurement standards starting with the fiscal year beginning January 1, 2018. The procurement standards include general standards related to policies and procedures and five methods of procurement. We recommend that the City review the guidance available on the OMB website as soon as possible to ensure compliance with the procurement standards.

Management's Response: The City has already reviewed the new guidelines and modified its purchasing policy appropriately in order to achieve timely compliance

Documenting Procurement Requirements Related to Suspension and Debarment

The Lead-Based Paint Hazard Control (LEAD) program project files contain no documentation indicating that, prior to being awarded a contract, the contractors were reviewed to ensure that they were not suspended or debarred parties. Through discussions with Department of Building and Housing Development (DBHD) management, DBHD utilizes the Excluded Parties Listing System (EPLS) website to review for suspended or debarred contractors. This review is completed prior to awarding a contract with federal funds. The contractors related to the LEAD construction projects selected for testing were not suspended or debarred, based on a review of the EPLS website. However, the project files did not contain related supporting documentation. We recommend that procedures be implemented to document in the project files that a contractor is not suspended or debarred prior to being awarded a contract.

Management's Response: The City concurs and will endeavor to take appropriate steps to effectuate inclusion of such documentation within the involved project files.

Obtaining Proper Approval

The City's policy requires that requisitions for disbursement have five levels of review and approval – Budget Manager, Department Head, Finance Director, Purchasing Manager, and Deputy Controller. For one of the 25 disbursements selected for testing, no departmental head approval was noted. We recommend that the City follow its policy and all invoices be approved by the department head and that the approval be appropriately documented.

Management's Response: The City concurs and has always endeavored to review every invoice for proper signatures.

Implementing Standards and Interpretations of the Governmental Accounting Standards Board (GASB)

GASB Statement No. 75, *"Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions"*

The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions (other postemployment benefits or OPEB). It also improves information provided by state and local governmental employers about financial support for OPEB that is provided by other entities. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all postemployment benefits (pensions and OPEB) with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency.

This Statement replaces the requirements of Statements No. 45, *"Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions,"* as amended, and No. 57, *"OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans,"* for OPEB. Statement No. 74, *"Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans,"* establishes new accounting and financial reporting requirements for OPEB plans. The scope of this Statement addresses accounting and financial reporting for OPEB that is provided to the employees of state and local governmental employers. This Statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. For defined benefit OPEB, this Statement identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and required supplementary information requirements about defined benefit OPEB also are addressed.

In addition, this Statement details the recognition and disclosure requirements for employers with payables to defined benefit OPEB plans that are administered through trusts that meet the specified criteria and for employers whose employees are provided with defined contribution OPEB. This Statement also addresses certain circumstances in which a nonemployer entity provides financial support for OPEB of employees of another entity. In this Statement, distinctions are made regarding the particular requirements depending upon whether the OPEB plans through which the benefits are provided are administered through trusts that meet the following criteria:

- Contributions from employers and nonemployer contributing entities to the OPEB plan and earnings on those contributions are irrevocable.
- OPEB plan assets are dedicated to providing OPEB to plan members in accordance with the benefit terms.
- OPEB plan assets are legally protected from the creditors of employers, nonemployer contributing entities, the OPEB plan administrator, and the plan members.

This Statement is effective for fiscal years beginning after June 15, 2017. Earlier application is encouraged.

GASB Statement No. 83, *"Certain Asset Retirement Obligations"*

This Statement addresses accounting and financial reporting for certain asset retirement obligations (AROs). An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability based on the guidance in this Statement.

This Statement establishes criteria for determining the timing and pattern of recognition of a liability and a corresponding deferred outflow of resources for AROs. This Statement requires that recognition occur when the liability is both incurred and reasonably estimable. The determination of when the liability is incurred should be based on the occurrence of external laws, regulations, contracts, or court judgments, together with the occurrence of an internal event that obligates a government to perform asset retirement activities. Laws and regulations may require governments to take specific actions to retire certain tangible capital assets at the end of the useful lives of those capital assets, such as decommissioning nuclear reactors and dismantling and removing sewage treatment plants. Other obligations to retire tangible capital assets may arise from contracts or court judgments. Internal obligating events include the occurrence of contamination, placing into operation a tangible capital asset that is required to be retired, abandoning a tangible capital asset before it is placed into operation, or acquiring a tangible capital asset that has an existing ARO.

This Statement requires the measurement of an ARO to be based on the best estimate of the current value of outlays expected to be incurred. The best estimate should include probability weighting of all potential outcomes, when such information is available or can be obtained at reasonable cost. If probability weighting is not feasible at reasonable cost, the most likely amount should be used. This Statement requires that a deferred outflow of resources associated with an ARO be measured at the amount of the corresponding liability upon initial measurement.

This Statement requires the current value of a government's AROs to be adjusted for the effects of general inflation or deflation at least annually. In addition, it requires a government to evaluate all relevant factors at least annually to determine whether the effects of one or more of the factors are expected to significantly change the estimated asset retirement outlays. A government should remeasure an ARO only when the result of the evaluation indicates there is a significant change in the estimated outlays. The deferred outflows of resources should be reduced and recognized as outflows of resources (for example, as an expense) in a systematic and rational manner over the estimated useful life of the tangible capital asset.

A government may have a minority share (less than 50 percent) of ownership interest in a jointly owned tangible capital asset in which a nongovernmental entity is the majority owner and reports its ARO in accordance with the guidance of another recognized accounting standards setter. Additionally, a government may have a minority share of ownership interest in a jointly owned tangible capital asset in which no joint owner has a majority ownership, and a nongovernmental joint owner that has operational responsibility for the jointly owned tangible capital asset reports the associated ARO in accordance with the guidance of another recognized accounting standards setter. In both situations, the government's minority share of an ARO should be reported using the measurement produced by the nongovernmental majority owner or the nongovernmental minority owner that has operational responsibility, without adjustment to conform to the liability measurement and recognition requirements of this Statement.

In some cases, governments are legally required to provide funding or other financial assurance for their performance of asset retirement activities. This Statement requires disclosure of how those funding and assurance requirements are being met by a government, as well as the amount of any assets restricted for payment of the government's AROs, if not separately displayed in the financial statements.

This Statement also requires disclosure of information about the nature of a government's AROs, the methods and assumptions used for the estimates of the liabilities, and the estimated remaining useful life of the associated tangible capital assets. If an ARO (or portions thereof) has been incurred by a government but is not yet recognized because it is not reasonably estimable, the government is required to disclose that fact and the reasons therefor. This Statement requires similar disclosures for a government's minority shares of AROs.

The requirements of this Statement are effective for reporting periods beginning after June 15, 2018. Earlier application is encouraged.

GASB Statement No. 84, *"Fiduciary Activities"*

The objective of this Statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported.

This Statement establishes criteria for identifying fiduciary activities of all state and local governments. The focus of the criteria generally is on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. Separate criteria are included to identify fiduciary component units and postemployment benefit arrangements that are fiduciary activities.

An activity meeting the criteria should be reported in a fiduciary fund in the basic financial statements. Governments with activities meeting the criteria should present a statement of fiduciary net position and a statement of changes in fiduciary net position. An exception to that requirement is provided for a business-type activity that normally expects to hold custodial assets for three months or less.

This Statement describes four fiduciary funds that should be reported, if applicable: (1) pension (and other employee benefit) trust funds, (2) investment trust funds, (3) private-purpose trust funds, and (4) custodial funds. Custodial funds generally should report fiduciary activities that are not held in a trust or equivalent arrangement that meets specific criteria.

A fiduciary component unit, when reported in the fiduciary fund financial statements of a primary government, should combine its information with its component units that are fiduciary component units and aggregate that combined information with the primary government's fiduciary funds.

This Statement also provides for recognition of a liability to the beneficiaries in a fiduciary fund when an event has occurred that compels the government to disburse fiduciary resources. Events that compel a government to disburse fiduciary resources occur when a demand for the resources has been made or when no further action, approval, or condition is required to be taken or met by the beneficiary to release the assets.

The requirements of this Statement are effective for reporting periods beginning after December 15, 2018. Earlier application is encouraged.

GASB Statement No. 85, *"Omnibus 2017"*

The objective of this Statement is to address practice issues that have been identified during implementation and application of certain GASB Statements. This Statement addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and post-employment benefits (pensions and other post-employment benefits [OPEB]). Specifically, this Statement addresses the following topics:

- Blending a component unit in circumstances in which the primary government is a business-type activity that reports in a single column for financial statement presentation
- Reporting amounts previously reported as goodwill and "negative" goodwill
- Classifying real estate held by insurance entities
- Measuring certain money market investments and participating interest-earning investment contracts at amortized cost
- Timing of the measurement of pension or OPEB liabilities and expenditures recognized in financial statements prepared using the current financial resources measurement focus
- Recognizing on-behalf payments for pensions or OPEB in employer financial statements
- Presenting payroll-related measures in required supplementary information for purposes of reporting by OPEB plans and employers that provide OPEB
- Classifying employer-paid member contributions for OPEB
- Simplifying certain aspects of the alternative measurement method for OPEB
- Accounting and financial reporting for OPEB provided through certain multiple-employer defined benefit OPEB plans.

The requirements of this Statement are effective for reporting periods beginning after June 15, 2017. Earlier application is encouraged.

GASB Statement No. 86, *"Certain Debt Extinguishment Issues"*

This Statement improves consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources—resources other than the proceeds of refunding debt—are placed in an irrevocable trust for the sole purpose of extinguishing debt. This Statement also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to financial statements for debt that is defeased in substance.

GASB Statement No. 7, *"Advance Refundings Resulting in Defeasance of Debt,"* requires that debt be considered defeased in substance when the debtor irrevocably places cash or other monetary assets acquired with refunding debt proceeds in a trust to be used solely for satisfying scheduled payments of both principal and interest of the defeased debt. The trust also is required to meet certain conditions for the transaction to qualify as an in-substance defeasance. This Statement establishes essentially the same requirements for when a government places cash and other monetary assets acquired with only existing resources in an irrevocable trust to extinguish the debt. However, in financial statements using the economic resources measurement focus, governments should recognize any difference between the reacquisition price (the amount required to be placed in the trust) and the net carrying amount of the debt defeased in substance using only existing resources as a separately identified gain or loss in the period of the defeasance. Governments that defease debt using only existing resources should provide a general description of the transaction in the notes to financial statements in the period of the defeasance. In all periods following an in-substance defeasance of debt using only existing resources, the amount of that debt that remains outstanding at period-end should be disclosed.

For governments that extinguish debt, whether through a legal extinguishment or through an in-substance defeasance, this Statement requires that any remaining prepaid insurance related to the extinguished debt be included in the net carrying amount of that debt for the purpose of calculating the difference between the reacquisition price and the net carrying amount of the debt.

One of the criteria for determining an in-substance defeasance is that the trust hold only monetary assets that are essentially risk-free. If the substitution of essentially risk-free monetary assets with monetary assets that are not essentially risk-free is not prohibited, governments should disclose that fact in the period in which the debt is defeased in substance. In subsequent periods, governments should disclose the amount of debt defeased in substance that remains outstanding for which that risk of substitution exists.

The requirements of this Statement are effective for reporting periods beginning after June 15, 2017. Earlier application is encouraged.

GASB Statement No. 87, *"Leases"*

The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities.

A lease is defined as a contract that conveys control of the right to use another entity's nonfinancial asset (the underlying asset) as specified in the contract for a period of time in an exchange or exchange-like transaction. Examples of nonfinancial assets include buildings, land, vehicles, and equipment. Any contract that meets this definition should be accounted for under the leases guidance, unless specifically excluded in this Statement.

The lease term is defined as the period during which a lessee has a noncancelable right to use an underlying asset, plus the following periods, if applicable:

a. Periods covered by a lessee's option to extend the lease if it is reasonably certain, based on all relevant factors, that the lessee will exercise that option
b. Periods covered by a lessee's option to terminate the lease if it is reasonably certain, based on all relevant factors, that the lessee will not exercise that option
c. Periods covered by a lessor's option to extend the lease if it is reasonably certain, based on all relevant factors, that the lessor will exercise that option
d. Periods covered by a lessor's option to terminate the lease if it is reasonably certain, based on all relevant factors, that the lessor will not exercise that option.

A fiscal funding or cancellation clause should affect the lease term only when it is reasonably certain that the clause will be exercised.

Lessees and lessors should reassess the lease term only if one or more of the following occur:

a. The lessee or lessor elects to exercise an option even though it was previously determined that it was reasonably certain that the lessee or lessor would not exercise that option.
b. The lessee or lessor elects not to exercise an option even though it was previously determined that it was reasonably certain that the lessee or lessor would exercise that option.
c. An event specified in the lease contract that requires an extension or termination of the lease takes place.

A short-term lease is defined as a lease that, at the commencement of the lease term, has a maximum possible term under the lease contract of 12 months (or less), including any options to extend, regardless of their probability of being exercised. Lessees and lessors should recognize short-term lease payments as outflows of resources or inflows of resources, respectively, based on the payment provisions of the lease contract.

A lessee should recognize a lease liability and a lease asset at the commencement of the lease term, unless the lease is a short-term lease or it transfers ownership of the underlying asset. The lease liability should be measured at the present value of payments expected to be made during the lease term (less any lease incentives). The lease asset should be measured at the amount of the initial measurement of the lease liability, plus any payments made to the lessor at or before the commencement of the lease term and certain direct costs.

A lessee should reduce the lease liability as payments are made and recognize an outflow of resources (for example, expense) for interest on the liability. The lessee should amortize the lease asset in a systematic and rational manner over the shorter of the lease term or the useful life of the underlying asset. The notes to financial statements should include a description of leasing arrangements, the amount of lease assets recognized, and a schedule of future lease payments to be made.

A lessor should recognize a lease receivable and a deferred inflow of resources at the commencement of the lease term, with certain exceptions for leases of assets held as investments, certain regulated leases, short-term leases, and leases that transfer ownership of the underlying asset. A lessor should not derecognize the asset underlying the lease. The lease receivable should be measured at the present value of lease payments expected to be received during the lease term. The deferred inflow of resources should be measured at the value of the lease receivable plus any payments received at or before the commencement of the lease term that relate to future periods.

A lessor should recognize interest revenue on the lease receivable and an inflow of resources (for example, revenue) from the deferred inflows of resources in a systematic and rational manner over the term of the lease. The notes to financial statements should include a description of leasing arrangements and the total amount of inflows of resources recognized from leases.

Generally, a government should account for the lease and nonlease components of a lease as separate contracts. If a lease involves multiple underlying assets, lessees and lessors in certain cases should account for each underlying asset as a separate lease contract. To allocate the contract price to different components, lessees and lessors should use contract prices for individual components as long as they do not appear to be unreasonable based on professional judgment, or use professional judgment to determine their best estimate if there are no stated prices or if stated prices appear to be unreasonable. If determining a best estimate is not practicable, multiple components in a lease contract should be accounted for as a single lease unit. Contracts that are entered into at or near the same time with the same counterparty and that meet certain criteria should be considered part of the same lease contract and should be evaluated in accordance with the guidance for contracts with multiple components.

An amendment to a lease contract should be considered a lease modification, unless the lessee's right to use the underlying asset decreases, in which case it would be a partial or full lease termination. A lease termination should be accounted for by reducing the carrying values of the lease liability and lease asset by a lessee, or the lease receivable and deferred inflows of resources by the lessor, with any difference being recognized as a gain or loss. A lease modification that does not qualify as a separate lease should be accounted for by remeasuring the lease liability and adjusting the related lease asset by a lessee and remeasuring the lease receivable and adjusting the related deferred inflows of resources by a lessor.

Subleases should be treated as transactions separate from the original lease. The original lessee that becomes the lessor in a sublease should account for the original lease and the sublease as separate transactions, as a lessee and lessor, respectively.

A transaction qualifies for sale-leaseback accounting only if it includes a sale. Otherwise, it is a borrowing. The sale and lease portions of a transaction should be accounted for as separate sale and lease transactions, except that any difference between the carrying value of the capital asset that was sold and the net proceeds from the sale should be reported as a deferred inflow of resources or a deferred outflow of resources and recognized over the term of the lease.

A lease-leaseback transaction should be accounted for as a net transaction. The gross amounts of each portion of the transaction should be disclosed.

The requirements of this Statement are effective for reporting periods beginning after December 15, 2019. Earlier application is encouraged.

Leases should be recognized and measured using the facts and circumstances that exist at the beginning of the period of implementation (or, if applied to earlier periods, the beginning of the earliest period restated). However, lessors should not restate the assets underlying their existing sales-type or direct financing leases. Any residual assets for those leases become the carrying values of the underlying assets.

GASB Statement No. 88, *"Certain Disclosures Related to Debt, Including Direct Borrowing and Direct Placements"*

The primary objective of this Statement is to improve the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. It also clarifies which liabilities governments should include when disclosing information related to debt.

This Statement defines debt for purposes of disclosure in notes to financial statements as a liability that arises from a contractual obligation to pay cash (or other assets that may be used in lieu of cash) in one or more payments to settle an amount that is fixed at the date the contractual obligation is established.

This Statement requires that additional essential information related to debt be disclosed in notes to financial statements, including unused lines of credit; assets pledged as collateral for the debt; and terms specified in debt agreements related to significant events of default with finance-related consequences, significant termination events with finance-related consequences, and significant subjective acceleration clauses.

For notes to financial statements related to debt, this Statement also requires that existing and additional information be provided for direct borrowings and direct placements of debt separately from other debt.

The requirements of this Statement are effective for reporting periods beginning after June 15, 2018. Earlier application is encouraged.

The requirements of this Statement will improve financial reporting by providing users of financial statements with essential information that currently is not consistently provided. In addition, information about resources to liquidate debt and the risks associated with changes in terms associated with debt will be disclosed. As a result, users will have better information to understand the effects of debt on a government's future resource flows.

GASB Statement No. 89. *"Accounting for Interest Cost Incurred Before the End of a Construction Period"*

The objectives of this Statement are (1) to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and (2) to simplify accounting for interest cost incurred before the end of a construction period.

This Statement establishes accounting requirements for interest cost incurred before the end of a construction period. Such interest cost includes all interest that previously was accounted for in accordance with the requirements of paragraphs 5–22 of Statement No. 62, *"Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements,"* which are superseded by this Statement. This Statement requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. As a result, interest cost incurred before the end of a construction period will not be included in the historical cost of a capital asset reported in a business-type activity or enterprise fund.

This Statement also reiterates that in financial statements prepared using the current financial resources measurement focus, interest cost incurred before the end of a construction period should be recognized as an expenditure on a basis consistent with governmental fund accounting principles.

The requirements of this Statement are effective for reporting periods beginning after December 15, 2019. Earlier application is encouraged.