

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 financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Harrisburg (City) as of and for the year ended December 31, 2018, 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 27, 2019, 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 27, 2019. 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 27, 2019 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, 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 27, 2019

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Management Letter

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

As previously noted in the December 31, 2005 through December 31, 2017 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. Such applicable policy and/or procedures will be developed to include a quarterly or at least annual review comprised of communication inquiry to the City's Public Works department for the occurrence of any such internally constructed capital assets.

Inventorying Capital Assets

As previously noted in the December 31, 2007 through December 31, 2017 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, as staffing resources allow, to develop and implement appropriate procedures for inventorying its capital assets periodically enabling the ongoing fixed assets accounting maintenance for additions, transfers, and disposals. Also, the Accounting Manager, for future audit preparation work, will develop a procedural process comprised of recording capital asset additions to the fixed assets system with included delegation to another member of the City accounting staff.

Developing Formal Program and System Change Control Policies and Procedures

As previously noted in the December 31, 2005 through December 31, 2017 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. Due to other priorities, the formal development of a process has been delayed. During the year, the strategy and focus has been to move away from custom developed systems and migrate to industry standard commercial off-the-shelf (COTS) systems.

Because of this, system changes have been kept to a minimum, and will continue to be kept to a minimum, knowing that the current systems will ultimately be retired.

Providing IT Employee Training

As previously noted in the December 31, 2005 through December 31, 2017 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 was completed during the fourth quarter of 2018. However, a formal training schedule has not yet been developed. Any external training 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, 2017 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 has engaged with external Data Center entities to provide redundancy of our existing Data Center. Working with our IBM Mainframe maintenance vendor, we installed, tested, and implemented a virtual tape server that allows us to backup all Mainframe systems and data to virtual tapes and replicate them to a Data Center in Altoona, Iowa, for disaster recovery purposes. 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 disaster recovery capabilities for the open systems environment to be completed by the end of the 2nd quarter of 2020. The implementation of these plans will depend on available funds within the budget.

Reviewing Physical and Logical Access Controls

During our review of the City's information technology systems, we noted that there was an individual no longer employed by the City who continues to be listed as an active user in the accounting system. In addition, there was another employee that had access that could be further restricted to better match that employee's job duties.

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 systems. In addition, a policy should be implemented requiring removal of user accounts from the network and applications when an individual ends their employment with the City.

Management's Response: The City currently has in effect updated onboarding/offboarding procedures for controlling proper access to the various systems deployed throughout the City. Periodic reviews of system access will continue to be performed for ensuring terminated employees are removed from City systems in a timely manner. More specifically for the Pentamation accounting system, the Accounting Manager will perform an additional year-end review of user profiles for any appropriate adjustments or needed deletions.

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. Now that our Mainframe virtual tape server solution is complete, we will work on being able to restore the backups at the Data Center in Altoona, Iowa. We anticipate being able to restore that environment in the second quarter of 2020. Once we have another Data Center facility 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 Minimum Access Policy addresses the use of City owned and privately-owned devices that connect to the City's network. The policy addresses anti-virus software, to ensure the security of the City data that is being accessed from that device.

Converting Vacation Carryover Balances for Firefighters

As previously noted in the December 31, 2014 through December 31, 2017 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 four firefighters had accrued vacation balances at December 31, 2018 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 planned to include this system modification on its list of projects to consider in 2019. However, with the focus to migrate the mainframe Personnel system to a new system, this modification has not been started. The conversion will be addressed as part of the migration to a new system.

Establishing Procedures for Follow up of Delinquent Sanitation and Disposal Accounts

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. Currently, there are no procedures in place for follow-up on delinquent accounts or for the determination of accounts that are to be written off as uncollectible. We recommend that procedures be implemented for follow up of delinquent accounts and for the determination of accounts that are to be written off as uncollectible.

Management's Response: The City concurs with this recommendation which involves the Neighborhood Services functions and is currently reviewing the existing policy and/or procedures related to the utility billing account system. Specifically, such efforts are being focused on expanding the involved process and needed internal controls, including related internal communications, for reviewing proposed utility billing account adjustments prior to the actual implementation of such adjustments.

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 years ended December 31, 2017 and 2018.
- 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. As previously noted in the December 31, 2017 audit and 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 years ended December 31, 2017 and 2018; 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 is mindful of the importance and nature of the recommendation being suggested here; 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. The City does continue to separately track such CRW water and sewer retiree other post-employment benefit costs and related offsetting revenue throughout the year, via consistent accounting entries to specifically

established and maintained accounts for ultimate reconciliation at year-end with the annual audit preparation work.

Obtaining Required Signatures on Manual Checks

As previously noted in the December 31, 2016 and 2017 audits, 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. Such consideration could include developing a related prepared summary of intended disbursements for distribution by the Treasurer to the Controller prior to the release of such disbursements.

Documenting Procurement Requirements Related to Suspension and Debarment

The Lead-Based Paint Hazard Control (LEAD) program and Community Development Block Grant (CDBG) 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 and CDBG 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 action to effectuate inclusion of such documentation within the involved project files. The Bureau of Financial Management will advise DBHD to make reference to such existing file documentation

within the notes section of the applicable system requisition prior to the approval of the related purchase order for the contractor.

Approving Journal Entries

Per the City's policy, journal entries prepared by the Accounting Manager are to be reviewed by the Finance Director prior to posting to the general ledger. During the audit, we noted that there were numerous Period 13 journal entries that were posted to the general ledger prior to being reviewed by the Finance Director. We recommend that the City follow its policy regarding review and recording of journal entries.

Management's Response: Though all period 13 adjustments are made available for review within the applicable audit sub-folder and have a reconciled basis via supporting workpapers, for future audit preparation work the Accounting Manager will work to schedule in a procedural process enabling the Finance Director's more directly focused review of all such adjustments proposed for posting.

Monitoring Time Clock Usage

Certain employees of the City utilize a time clock to record hours worked. Employees are provided an individual timecard that is maintained alongside the time clock. Employees clock in and out by swiping their assigned timecard. During the audit, it was noted that certain employees were swiping cards for other employees. In order to ensure accurate tracking of employee hours worked, we recommend that the City monitor the time clock to ensure that an employee is clocking in and out using only their assigned timecard.

Management's Response: The involved City office or department has been informed of these actions via communication to the in-charge Director who has conveyed proper corrective action to the applicable employees for their awareness and a ceasing of such activity.

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

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. 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 Borrowings 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.

GASB Statement No. 91, “Conduit Debt Obligations”

The primary objectives of this Statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. This Statement achieves those objectives by clarifying the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures.

A conduit debt obligation is defined as a debt instrument having all of the following characteristics:

- There are at least three parties involved: (1) an issuer, (2) a third-party obligor, and (3) a debt holder or a debt trustee.
- The issuer and the third-party obligor are not within the same financial reporting entity.
- The debt obligation is not a parity bond of the issuer, nor is it cross-collateralized with other debt of the issuer.
- The third-party obligor or its agent, not the issuer, ultimately receives the proceeds from the debt issuance.
- The third-party obligor, not the issuer, is primarily obligated for the payment of all amounts associated with the debt obligation (debt service payments).

All conduit debt obligations involve the issuer making a limited commitment. Some issuers extend additional commitments or voluntary commitments to support debt service in the event the third party is, or will be, unable to do so.

An issuer should not recognize a conduit debt obligation as a liability. However, an issuer should recognize a liability associated with an additional commitment or a voluntary commitment to support debt service if certain recognition criteria are met. As long as a conduit debt obligation

is outstanding, an issuer that has made an additional commitment should evaluate at least annually whether those criteria are met. An issuer that has made only a limited commitment should evaluate whether those criteria are met when an event occurs that causes the issuer to reevaluate its willingness or ability to support the obligor's debt service through a voluntary commitment.

This Statement also addresses arrangements—often characterized as leases—that are associated with conduit debt obligations. In those arrangements, capital assets are constructed or acquired with the proceeds of a conduit debt obligation and used by third-party obligors in the course of their activities. Payments from third-party obligors are intended to cover and coincide with debt service payments. During those arrangements, issuers retain the titles to the capital assets. Those titles may or may not pass to the obligors at the end of the arrangements.

Issuers should not report those arrangements as leases, nor should they recognize a liability for the related conduit debt obligations or a receivable for the payments related to those arrangements. In addition, the following provisions apply:

- If the title passes to the third-party obligor at the end of the arrangement, an issuer should not recognize a capital asset.
- If the title does not pass to the third-party obligor and the third party has exclusive use of the entire capital asset during the arrangement, the issuer should not recognize a capital asset until the arrangement ends.
- If the title does not pass to the third-party obligor and the third party has exclusive use of only portions of the capital asset during the arrangement, the issuer, at the inception of the arrangement, should recognize the entire capital asset and a deferred inflow of resources. The deferred inflow of resources should be reduced, and an inflow recognized, in a systematic and rational manner over the term of the arrangement.

This Statement requires issuers to disclose general information about their conduit debt obligations, organized by type of commitment, including the aggregate outstanding principal amount of the issuers' conduit debt obligations and a description of each type of commitment. Issuers that recognize liabilities related to supporting the debt service of conduit debt obligations also should disclose information about the amount recognized and how the liabilities changed during the reporting period.

The requirements of this Statement are effective for reporting periods beginning after December 15, 2020.