

This letter contains redacted information which refers to details of control weaknesses that were communicated to locality management and governance but are FOIAE under Code of Virginia §2.2-3705.2 due its sensitivity and description of security controls or mechanisms.

**TOWN OF COLONIAL BEACH, VIRGINIA AND
COLONIAL BEACH PUBLIC SCHOOLS**

**COMMENTS ON INTERNAL CONTROL AND
OTHER SUGGESTIONS FOR YOUR
CONSIDERATION**

June 30, 2017

TABLE OF CONTENTS

	Page
INDEPENDENT AUDITOR'S REPORT ON COMMENTS AND SUGGESTIONS	3
COMMENTS AND SUGGESTIONS	5
PRIOR YEAR COMMENTS AND SUGGESTIONS	6
ACCOUNTING AND OTHER MATTERS	9

INDEPENDENT AUDITOR'S REPORT ON COMMENTS AND SUGGESTIONS

To the Honorable Members of Town Council
and School Board
Town of Colonial Beach, Virginia

In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, the discretely presented component unit and each major fund of the Town of Colonial Beach, Virginia (the "Town") as of and for the year ended June 30, 2017, in accordance with auditing standards generally accepted in the United States of America, we considered its internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in circumstances for the purpose of expressing our opinion on the financial statements and to comply with any other applicable standards, such as *Government Auditing Standards* and the regulations set forth in the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we do not express an opinion on the effectiveness of the entity's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls. As discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

If material weaknesses or significant deficiencies were identified during our procedures, they are appropriately designated as such in this report. Additional information on material weaknesses or significant deficiencies and compliance and other matters is included 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*** which should be read in conjunction with this report.

Additionally, during our audit, we may have become aware of certain other matters that provide opportunities for improving your financial reporting system and/or operating efficiency. Such comments and suggestions regarding these matters, if any, are also included in the attached report, but are not designated as a material weakness or significant deficiency. Since our audit is not designed to include a detail review of all systems and procedures, these comments should not be considered as being all-inclusive of areas where improvements might be achieved. We also have included information on accounting and other matters that we believe is important enough to merit consideration by management and those charged with governance. It is our hope that our suggestions will be taken in the constructive light in which they are offered.

We have already discussed these comments and suggestions with management, and 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. A review of the status of prior year comments and suggestions is included on pages 5 through 8.

The Town's responses to our recommendations are included in this report. The responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of Town Council, School Board, management, and state and federal regulatory agencies and is not intended to be, and should not be, used by anyone other than these specified parties.

Brown, Edwards & Company, L.L.P.

CERTIFIED PUBLIC ACCOUNTANTS

Harrisonburg, Virginia
November 30, 2017

**TOWN OF COLONIAL BEACH, VIRGINIA
COMMENTS AND SUGGESTIONS**

TOWN

ALLOWANCE FOR DOUBTFUL ACCOUNTS (PART OF AUDIT ADJUSTMENTS MATERIAL WEAKNESS)

The allowance for doubtful accounts is not being analyzed periodically to adjust for uncollectible accounts. Bad debt write-offs are also not being performed. We recommend that management prepare an analysis of uncollectible accounts at least quarterly. This analysis should consider prior charge-off experience and experience with the customer, as well as other information management may have about the account, such as indications of financial difficulty. We also recommend that write-offs in excess of a given amount be further reviewed and approved by a responsible member of management on a monthly or quarterly basis.

Management's Response: Staff agrees the allowance needs to be adjusted and will bring to counsel to discuss the write-off.

GRANT RECEIVABLE (Part of Audit Adjustments Material Weakness)

The Town does not track grant reimbursements consistently, which has resulted in significant audit adjustments to correct accounts receivable and revenue. The Town should implement a process to ensure grant reimbursement requests are submitted timely and subsequently received in the Treasurer's Office.

Management's Response: Staff is in agreement and will track reimbursements more closely.

UTILITY ACCOUNT REVIEW

Two utility account balances continue to increase due to system generated entries. The Town is unaware what the balance represents. We recommend the Town review detail for both accounts to determine proper classification.

Management's Response: In FY18 Town staff will do a thorough review of how the UT system is applying these pre-payments and make a determination of how to proceed, whether it is an adjusting entry or having BAI make a change in the system.

**TOWN OF COLONIAL BEACH, VIRGINIA
PRIOR YEAR COMMENTS AND SUGGESTIONS**

TOWN

SEGREGATION OF DUTIES (Current and Prior Year Material Weakness)

One of the more important aspects of any internal control is the segregation of duties. In an ideal system of internal controls, no individual would perform more than one duty in connection with any transaction or series of transactions. In particular, no one individual should have access to both physical assets and the related accounting records. Such access may allow errors or irregularities to occur and either not be detected or concealed. We understand that due to the size of the Treasurer's Office, it may be impractical to completely separate all of these duties.

Specific items related to segregation of duties are discussed below:

- Certain finance department personnel have the ability to collect cash and perform write-offs. The Accounting Manager and the Revenue Payment Manager also have the ability to prepare bills, edit the accounts payable master file, and prepare checks.
- The Accounting Manager has the ability to process payroll and change master payroll file information. If possible, we recommend that an individual independent of payroll processing, review a file change log, to ensure that all changes made to the master payroll file have been approved.
- The Chief Financial Officer has the ability to approve changes in the financial software (BAI). This role has been expanded recently to manage security related concerns relating to the information system.

Current Status: *The above comments are still applicable.*

Management's Response: Current staffing levels make a total separation of duties impossible to implement. Over the last three years, Management made changes in procedures to improve the segregation of duties wherever possible. Due to turnover in the months following June 30, this will be a more challenging process for the coming year. We will continue to review our functions and procedures to minimize risk.

AUDIT ADJUSTMENTS (Current Year Material Weakness and Prior Year Significant Deficiency)

Audit procedures resulted in material audit adjustments to the financial statements. We recommend that the Town perform regular reconciliations and review of the general ledger to ensure that accounts are appropriately reconciled and reflect the correct balances.

Current Status: *The Town continued to have audit adjustments during the 2017 audit. See current year comments for more information.*

Management's Response: We continue to work with our outside consultants and auditors on infrequent and unusual issues to confirm proper accounting treatment.

**TOWN OF COLONIAL BEACH, VIRGINIA
PRIOR YEAR COMMENTS AND SUGGESTIONS (Continued)**

TOWN (Continued)

SYSTEM LOG REVIEW

Procedures to assure the completeness and accuracy of input data are partially implemented. There are no regular (automated or manual) reviews of critical logs, including System Administrator logs or exceptions. This increases the risk of an issue or exception remaining undetected. We recommend that the Town have an independent, knowledgeable employee review critical logs including Administrator activity, failed logins, and any others deemed significant by Town administration.

Current Status: *Comment is still applicable.*

Management's Response: Budgetary considerations make it unlikely that the Town will have an onsite IT employee in the near future. At this time, the reviews are done at intervals that are practical for our offsite IT contractors.

CORE SERVER

Access to the Town's data room where the server is located is controlled by the Chief Financial Officer. We recommend that administration and custody to information technology assets be restricted to information technology personnel with no transactional responsibility.

Current Status: *Comment is still applicable.*

Management's Response: As in the response above, the size of current staff and the diversity of individuals' responsibilities make this condition unavoidable. Locks with access codes have been installed with a limited number of individuals including administration only staff having custody of the access codes.

DISASTER RECOVERY

Full system backups are produced nightly. [REDACTED]
[REDACTED] We recommend that backup tapes be stored in a separate secured area in case of disaster or theft.

Current Status: *Comment is still applicable.*

Management's Response: [REDACTED]
[REDACTED]

**TOWN OF COLONIAL BEACH, VIRGINIA
PRIOR YEAR COMMENTS AND SUGGESTIONS (Continued)**

SCHOOLS

AUDIT ADJUSTMENTS (Current and Prior Year Material Weaknesses)

Audit procedures resulted in material audit adjustments to the financial statements. We recommend that the Schools perform regular reconciliations and review of the general ledger to ensure that accounts are appropriately reconciled and reflect the correct balances.

Current Status: *The Schools continued to have audit adjustments during the 2017 audit. Comment is still applicable.*

CORE SERVER

[REDACTED] No heat or smoke detection is in the area. We recommend that proper method of fire detection be put in place to prevent data loss in the event of a disaster.

Current Status: *Comment is no longer applicable. A smoke detector has been installed in this room.*

DISASTER RECOVERY

Full system backups are produced nightly. [REDACTED]
[REDACTED] We recommend that backup tapes be stored in a separate secured area in case of disaster or theft.

Current Status: [REDACTED]
[REDACTED]

SYSTEM LOG REVIEW

Procedures to assure the completeness and accuracy of input data are partially implemented. There are no regular (automated or manual) reviews of critical logs, including System Administrator logs or exceptions. This increases the risk of an issue or exception remaining undetected. We recommend that the Schools have an independent, knowledgeable employee review critical logs including Administrator activity, failed logins, and any others deemed significant by School administration.

Current Status: *An employee is now responsible for reviewing failed logins, ensuring logins are disabled as needed, and reviewing critical logs once a month. Comment is no longer applicable.*

ACCESS PERMISSIONS

There is currently no formal review of system access permissions. It is recommended that on a regular basis, system access rights be formally reviewed to ensure all current employees have appropriate access to the system and former employees' access have been removed.

Current Status: *Comment is no longer applicable. The Director of Finance now reviews access to the application on an annual basis.*

TOWN OF COLONIAL BEACH, VIRGINIA
ACCOUNTING AND OTHER MATTERS

In this section, we would like to make you aware of certain confirmed and potential changes that are on the horizon that may affect your financial reporting and audit.

GASB STATEMENT NO. 75

GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits other than Pensions* improves 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.

TOWN OF COLONIAL BEACH, VIRGINIA
ACCOUNTING AND OTHER MATTERS (Continued)

GASB STATEMENT NO. 75 (Continued)

GASB Statement No. 75 will be effective for the year ending June 30, 2018. To prepare for implementation of this new Statement, management should consult with the entity's external OPEB actuarial firm to ensure timely reporting and compliance with the requirements of this Statement.

GASB STATEMENT NO. 81

GASB Statement No. 81, *Irrevocable Split-Interest Agreements* will improve accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement.

Split-interest agreements are a type of giving agreement used by donors to provide resources to two or more beneficiaries, including governments. Split interest agreements can be created through trusts – or other legally enforceable agreements with characteristics that are equivalent to split-interest agreements – in which a donor transfers resources to an intermediary to hold and administer for the benefit of a government and at least one other beneficiary. Examples of these types of agreements include charitable lead trusts, charitable remainder trusts, and life-interests in real estate.

This Statement requires that a government that receives resources pursuant to an irrevocable split-interest agreement recognize assets, liabilities, and deferred inflows of resources at the inception of the agreement. Furthermore, this Statement requires that a government recognize assets representing its beneficial interests in irrevocable split-interest agreements that are administered by a third party, if the government controls the present service capacity of the beneficial interests. This Statement requires that a government recognize revenue when the resources become applicable to the reporting period.

GASB Statement No. 81 will be effective for the year ending June 30, 2018.

GASB STATEMENT NO. 82

The objective of **GASB Statement No. 82, *Pension Issues – an amendment of GASB Statements No. 67, No. 68, and No. 73*** is to address certain issues that have been raised with respect to Statements No. 67, *Financial Reporting for Pension Plans*, No. 68, *Accounting and Financial Reporting for Pensions*, and No. 73, *Accounting and Financial Reporting for Pensions and Related Assets* that are not within the scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68. Specifically, this Statement addresses issues regarding the presentation of payroll-related measures in required supplementary information, the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and the classification of payments made by employers to satisfy employee (plan member) contribution requirements.

The requirements of this Statement are effective for the year ended June 30, 2017, except for the requirements of this Statement for the selection of assumptions in a circumstance in which an employer's pension liability is measured as of a date other than the employer's most recent fiscal year-end. In that circumstance, the requirements for the selection of assumptions are effective for that employer in the first reporting period in which the measurement date of the pension liability is on or after June 15, 2017.

TOWN OF COLONIAL BEACH, VIRGINIA
ACCOUNTING AND OTHER MATTERS (Continued)

GASB STATEMENT NO. 83

GASB Statement No. 83, *Certain Asset Retirement Obligations* 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 re-measure 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.

TOWN OF COLONIAL BEACH, VIRGINIA
ACCOUNTING AND OTHER MATTERS (Continued)

GASB STATEMENT NO. 83 (Continued)

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.

GASB Statement No. 83 will be effective for the year ending June 30, 2019.

GASB STATEMENT NO. 84

The objective of **GASB Statement No. 84**, *Fiduciary Activities* 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.

TOWN OF COLONIAL BEACH, VIRGINIA
ACCOUNTING AND OTHER MATTERS (Continued)

GASB STATEMENT NO. 84 (Continued)

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.

GASB Statement No. 84 will be effective for the year ending June 30, 2020.

GASB STATEMENT NO. 85

The objective of **GASB Statement No. 85**, *Omnibus 2017*, 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 postemployment benefits (pensions and other postemployment 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.

GASB Statement No. 85 will be effective for the year ending June 30, 2018.

TOWN OF COLONIAL BEACH, VIRGINIA
ACCOUNTING AND OTHER MATTERS (Continued)

GASB STATEMENT NO. 86

The primary objective of **GASB Statement No. 86, *Certain Debt Extinguishment Issues*** is to improve 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.

In-Substance Defeasance of Debt Using Only Existing Resources

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.

Prepaid Insurance Related to Extinguished Debt

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.

Additional Disclosure for All In-Substance Defeasance Transactions

One of the criteria for determining an in-substance defeasance is that the trust holds 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.

GASB Statement No. 86 will be effective for the year ending June 30, 2018.

TOWN OF COLONIAL BEACH, VIRGINIA
ACCOUNTING AND OTHER MATTERS (Continued)

GASB STATEMENT NO. 87

The objective of **GASB Statement No. 87, *Leases***, 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.

Definition of a Lease

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.

Lease Term

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

- 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
- 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
- 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
- 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.

TOWN OF COLONIAL BEACH, VIRGINIA
ACCOUNTING AND OTHER MATTERS (Continued)

GASB STATEMENT NO. 87 (Continued)

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

- 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.
- 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.
- An event specified in the lease contract that requires an extension or termination of the lease takes place.

Short-Term Lease

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.

Lessee Accounting

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.

TOWN OF COLONIAL BEACH, VIRGINIA
ACCOUNTING AND OTHER MATTERS (Continued)

GASB STATEMENT NO. 87 (Continued)

Lessor Accounting

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.

Contracts with Multiple Components and Contract Combinations

Generally, a government should account for the lease and non-lease 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.

Lease Modifications and Terminations

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 re-measuring the lease liability and adjusting the related lease asset by a lessee and re-measuring the lease receivable and adjusting the related deferred inflows of resources by a lessor.

TOWN OF COLONIAL BEACH, VIRGINIA
ACCOUNTING AND OTHER MATTERS (Continued)

GASB STATEMENT NO. 87 (Continued)

Subleases and Leaseback Transactions

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.

GASB Statement No. 87 will be effective for the year ending June 30, 2021.

TOWN OF COLONIAL BEACH, VIRGINIA
ACCOUNTING AND OTHER MATTERS (Continued)

CURRENT GASB PROJECTS

GASB currently has a variety of projects in process. Some of these projects are as follows:

- ***Conceptual Framework – Recognition.*** The project’s objective is to develop recognition criteria for *whether* information should be reported in state and local governmental financial statements and *when* that information should be reported. This project ultimately will lead to a Concepts Statement on recognition of elements of financial statements. The project is currently in deliberations with an exposure draft expected in March 2020, with a final statement in November 2021.
- ***Financial Reporting Model.*** The objective of this project is to make improvements to the financial reporting model, including Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*, and other reporting model-related pronouncements (Statements No. 35, *Basic Financial Statements – and Management’s Discussion and Analysis – for Public Colleges and Universities*, No. 37, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments: Omnibus*, No. 41, *Budgetary Comparison Schedules – Perspective Differences*, and No. 46, *Net Assets Restricted by Enabling Legislation, and Interpretation No. 6, Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*). The objective of these improvements would be to enhance the effectiveness of the model in providing information that is essential for decision-making and enhance the ability to assess a government’s accounting and address certain application issues, based upon the results of the pre-agenda research on the financial reporting model. The project is currently in deliberations with an exposure draft expected in March 2020, with a final statement in November 2021.
- ***Revenue and Expense Recognition.*** The objective of this project is to develop a comprehensive application model for the recognition of revenues and expenses that arise from nonexchange, exchange, and exchange-like transactions, including guidance for exchange transactions that has not been specifically addressed in the current literature. The purpose for developing a comprehensive model is (1) to improve the information regarding revenues and expenses that users need to make decisions and assess accountability, (2) to provide guidance regarding exchange and exchange-like transactions that have not been specifically addressed, (3) to evaluate revenue and expense recognition in the context of the conceptual framework, and (4) to address application issues identified in practice, based upon the results of the pre-agenda research on revenue for exchange and exchange-like transactions. The project is currently in deliberations with an exposure draft expected in March 2021, with a final statement in June 2022.
- ***Capitalization of Interest Cost.*** The objective of this project is to reconsider the accounting and financial reporting standards for capitalization of interest cost, with the goal of enhancing the relevance of capital asset information and potentially simplifying financial reporting. In particular, the guidance will be reviewed in light of the definitions of financial statement elements now established in the GASB’s conceptual framework. This project has been added to the current technical agenda, with a final statement expected in June 2018.

TOWN OF COLONIAL BEACH, VIRGINIA
ACCOUNTING AND OTHER MATTERS (Continued)

CURRENT GASB PROJECTS (Continued)

- ***Equity Interest Ownership Issues.*** This project will address certain issues related to the reporting of majority equity ownership in legally separate entities. The project will consider improvements to the existing guidance in Statement No. 14, *The Financial Reporting Entity*, on the presentation of ownership interest in a legally separate entity. The project also will consider improvements to the recognition and measurement guidance for wholly-owned legally separate entities that are presented as component units. The project is currently in deliberations with a final statement expected in November 2018.