



PRINCE WILLIAM COUNTY

Prince William County, Virginia Internal Audit Report – Lease Accounting & Reporting – Governmental Accounting Standards Board Statement No. 87 Readiness Analysis

November 20, 2019





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TRANSMITTAL LETTER

November 20, 2019

The Board Audit Committee of
Prince William County, Virginia
1 County Complex Court
Prince William, Virginia 22192

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Pursuant to the internal audit plan for calendar year ending (“CY”) 2019 for Prince William County, Virginia (“County” / “PWC”), approved by the Board of County Supervisors (“BOCS”), we hereby present the lease accounting & reporting - Governmental Accounting Standards Board Statement No. 87 – readiness analysis. The purpose of this engagement was to perform an assessment of the County’s operating lease environment and to provide guidelines for implementation of Governmental Accounting Standards Board Statement No. 87. We will be presenting this report to the Board Audit Committee of Prince William County at the next scheduled meeting on December 10, 2019.

Our report is organized into the following sections:

Executive Summary	This provides a high-level overview and summary of the results noted in our readiness analysis.
Background	This provides an overview of the County’s lease accounting and reporting, the new accounting pronouncement, as well as other relevant background information.
Objectives and Approach	The objectives of this internal audit are expanded upon in this section, as well as the various phases of our approach.
Appendix	A risk and control matrix surrounding this process, and proposed implementation plan has been developed and provided to the County. These documents are for consideration to assist the County in their plan to be compliant with Governmental Accounting Standards Board Statement No. 87.

We would like to thank the staff and all those involved in assisting our firm with this internal audit.

Respectfully Submitted,

RSM US LLP

Internal Auditors



EXECUTIVE SUMMARY

Background

The Government Accounting Standards Board (“GASB”) has published its new lease accounting standards for governments following GASB accounting. The new GASB Statement No. 87 (“GASB 87”) was issued in June 2017 and will be effective for reporting periods beginning after December 15, 2019.

GASB 87 is a significant change in lease accounting, affecting nearly all governmental entities. The Financial Reporting & Control Accounting Division (“FRC”) within the County’s Finance Department, is responsible for maintaining the County’s books and records in accordance with Generally Accepted Accounting Principles (“GAAP”), and facilitating the annual audit of the County’s books and records as required by §15.2-2511 of the Code of Virginia. While FRC is responsible for preparing annual financial statements, GASB 87 will impact all County departments.

In the GASB’s view, leases are all assumed to be capital financings of the underlying assets with only a narrow range of short-term equipment and motor vehicle leases treated as an “operating lease.” Consequently, GASB no longer contemplates the subjective determination/distinction between an “operating lease” and a “capital lease;” GASB now assumes all leases are “capital leases” except for the specific exceptions. GASB 87 will now require recognition of assets and liabilities for all leases (with some limited exceptions) regardless of the prior accounting treatment (operating lease vs. capital lease).

The intent of this requirement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases; enhancing the comparability of financial statements between governments; including relevance, reliability, and consistency of information about the leasing activities of governments.

GASB 87 will have a significant impact on how the County recognizes and accounts for lease agreements. All operating leases will now be accounted for on the balance sheet in a similar fashion to capital leases causing an increase of gross assets and offsetting liability values. This change in accounting will require adjusted processes and collaboration with all County departments, and may require new technology, to identify current lease agreements that will be impacted and the appropriate operational changes for lease accounting going forward.

It is important to note that certain arrangements that are not structured as leases may contain “embedded leases”. Embedded leases are components within contracts that entail the use of a particular asset, where the user has control over that asset.

Objectives and Scope

GASB 87 is a new reporting requirement for the County for FY 2021, as such; the primary objective of this analysis was to assist the County in its proactive compliance efforts by performing an assessment of its operating lease environment and to provide guidelines for implementation. In addition, we assisted the County in accumulating and analyzing its readiness for print/copier managed services. Procedures included the following:

- Reviewed the current process that the County uses to identify, record, and track all operating lease arrangements, including accounting and financial reporting;
- Assessed readiness in adopting and implementing new GASB 87 lease accounting rules;
- Accumulated various printer and copier agreements utilized across the County through distribution of a survey regarding lease awareness among personnel;
- Assessed if the records and documentation for operating leases are sufficient to establish an audit trail for the completeness of tracking and recording of leases;
- Reviewed a sample of active leases related to print management services and identify possible cost savings measures;
- Identified opportunities for cost reduction and efficiency within printer and copier management; and
- Provided recommendations for process improvements.

Considering the volume of PWC’s operating lease portfolio and the technical nature of the GASB 87 standard changes, the County is at risk of untimely or inadequate adoption of GASB 87 and misstatements within the financial statements. Action for implementation of GASB 87 should be taken immediately. If not, this could present a high risk (i.e., impact on financial statements, internal control environment, brand, or business operations) to the County in the near future.

The undertaking that will be required of the County to comply with this new GASB 87 should not be underestimated.

Fieldwork was performed in July 2019 through October 2019.

We would like to thank all County team members who assisted us throughout this readiness analysis.



EXECUTIVE SUMMARY – CONTINUED

Summary of Analysis Results

The following summary provides key information from our analysis.

Lease Accounting Control Environment

GASB 87 requires a transition of accounting recognition for operating leases and a complete reflection of lease assets and liabilities on the face of the financial statements as detailed within the background section (see pages 6-10). Establishing compliance with GASB 87 is a data-intensive undertaking, which requires controls to obtain, and validate completeness and accuracy of the data used to generate lease accounting entries and disclosures.

The financial system used by the County, Ascend, manages lease accounting and reporting for capital leases, however, there are limited or no controls in place for the following areas:

- Lease population completeness and accuracy;
- New lease identification and valuation;
- Existing lease modification identification; and,
- Embedded lease identification.

The current financial system, Ascend, is not configured to enable accounting processes and control structure to meet GASB 87 lease standards. Only capital leases are currently captured as leased assets or liabilities.

To assist in this implementation, we created a risk and control matrix (“RACM”) provided in Appendix A listing appropriate lease accounting controls. As part of the development of the control environment, FRC should configure Ascend, if possible, to meet the needs of GASB 87 requirements. If Ascend is not able to be configured as needed, we recommend that an alternative lease accounting technology solution be identified and configured to include the following functions:

- Calculate future lease liability automatically based on net present value of future payments;
- Calculate the value of the right of use (ROU) asset;
- Separate lease and non-lease components for accounting purposes (e.g. embedded leases) and make payments and record expenses for each component as appropriate;
- Track applicable terms affecting lease period including renewals, options, expirations, etc. Terms should be stored within the system and notifications should be generated; and,
- Provide comprehensive disclosure reporting to assist with the enhanced disclosure requirements of GASB 87.

Implementation of new controls supported by Ascend, or an alternative solution, will simplify the transition to GASB 87 and maintain compliance with the new lease accounting requirements going forward.



EXECUTIVE SUMMARY – CONTINUED

Summary of Analysis Results – Continued

GASB 87 Implementation Plan

GASB 87 requirements have strong accounting and financial reporting implications due to the use of a variety of leasing arrangements by government entities. Implementation plans are effective tools for facilitating organizational change. In the case of GASB 87 an implementation plan should address the following, at minimum:

- Data extraction;
- Policy and procedure development;
- Technology configuration;
- Financial control implementation; and,
- Change management and communication.

We have provided the County with a proposed implementation plan, see Appendix B, for GASB 87 compliance, that includes at a minimum, the below activities. The County could also consider utilizing a technical accounting consultant.

- Lease identification:
 - Review of currently leased assets;
 - Review of service contracts for embedded leases;
- Extraction of data required by the new standards for all or a sample of leases;
- Preparation for applying new requirements to future leases;
- Valuation of leases previously classified as operating leases;
- Identify system configuration that meets GASB 87 needs;;
- Educating various stakeholders on the new standards and how it may impact their involvement in lease management;
- Assessment of retroactive application of new requirements for previously stated financial reports, if applicable; and,
- Ongoing interaction with external auditors and assistance with preparation of annual financial statement audit documentation.



EXECUTIVE SUMMARY – CONTINUED

Summary of Analysis Results – Continued

Shared Print Services

Currently, each County department/agency has discretion in procuring copiers and printers and the related contract management, under the purvue of the Finance Department’s Procurement Services Division. In order to gain an understanding of copier and printer management at the decentralized level we distributed a survey to all PWC departments to gather information on current lease agreements across the County. Based on responses from twenty-eight (28) departments, twenty-five (25) have lease agreements for copiers and printers. In addition, the following was noted during the survey process:

- The County is currently utilizing a minimum of nine (9) different agreements with six (6) office equipment vendors for the procurement of related copier machines and printing services. During FY 2019, the County spent \$1,721,973 for copier and printer services, with the following vendors:

Vendor	Spend
Canon	\$ 1,024,844
Xerox	433,124
Sharp	167,067
Ricoh	73,083
Edwards Business Machines	20,162
ESI	3,693

- As stated within copier and printer service agreements provided by departments, ~80 machines are incurring fixed monthly charges ranging from \$95 to \$551. Some agreements also include variable costs ranging from \$0.008 to \$0.055 per impression.

Note: These figures do not represent the full population of copier and printer service agreements across all departments, only what was provided in response to the distributed survey.

- Because of the decentralized nature of contract management, the County has limited insight into the procurement of copiers and printers and varying agreements utilized.
- Department of Information Technology (“DoIT”) identified ~2,400 copiers and printers utilizing the County’s network. The decentralized nature of the process likely limits the County’s ability to negotiate and maximize better rates or discounts.
- While tasks may be completed appropriately in the current decentralized structure, this creates potential for inefficiencies and ineffective processes. A decentralized program increases the risk of inefficient allocation of County resources by duplicating the work of processing invoices, monitoring equipment, and the maintenance of equipment across each department/agency.

To minimize costs and maximize efficiencies, the County should devise a plan to consolidate contracting and maximize buying power, while at the same time not jeopardize operations. While lowering total costs is important, there is no “one-size-fits-all” service, as many departments require varying functionality from their copiers and printers. Consolidation of agreements should lead to discounted pricing and a reduction in time spent by County resources.

Consolidation and centralization of the agreements will allow contract-monitoring procedures to be performed within DoIT as the shared print service program owner.



BACKGROUND

Overview

In June 2017, the Governmental Accounting Standards Board issued Statement No. 87 related to the accounting for lease assets and liabilities previously classified as “operating” leases. The requirements of this statement are effective for reporting periods beginning after December 15, 2019, however, adopted changes should be applied retroactively by restating financial statements, if practicable, for all prior periods presented.

GASB 87 will have a significant impact on how the County recognizes and accounts for lease agreements. All operating leases will now be accounted for on the County’s balance sheet in a similar fashion to capital leases causing an increase of gross assets and offsetting liability values. This change in the accounting standard will require adjusted processes; collaboration with all County departments, and possibly technology needs to identify current lease agreements impacted and the appropriate operational changes for lease accounting going forward.

Under GASB 87, lessees and lessors will be required to report leases under a single model. The intent of these new requirements is to enhance the relevance and consistency of information regarding lease activities and improve comparability of government financial statements. These changes will also improve the usefulness of financial statement information for users by requiring additional disclosures related to the timing, significance, and purpose of the leasing arrangements.

GASB 87 Lease Accounting

A lease as defined by the Governmental Accounting Standards Board is 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 in an exchange or exchange-like transaction.” Examples of nonfinancial assets include equipment, buildings, land, and vehicles. Any contract that meets this definition should be accounted for under the lease guidance, unless specifically excluded in GASB 87. Exclusions include: leases of intangible assets; leases of biological assets (timber as example); leases of inventory; contracts that meet the definition of a service concession arrangement; leases in which the underlying asset is financed with outstanding conduit debt, unless both the underlying asset and conduit debt are reported by the lessor; and supply contracts, such as power purchase agreements.

When accounting for agreements of this nature, there are a few key attributes that must be known and recorded by both the lessee (leaseholder, such as a tenant) and the lessor (person leasing the asset, such as a landlord).

GASB No. 87 - Impacted Areas

1. New Processes	
2. Training	
3. Technology	
4. More Detailed Reporting Requirements	
5. Technical Accounting Assessments	

Recognition and Measurement for Leases other than Short-Term Leases and Contracts that Transfer Ownership:

Lessee (lease holder)	<ul style="list-style-type: none"> At the commencement of the lease term, a lessee shall recognize a lease liability, at the present value of payments expected to be made during the lease term less any lease incentives, and an intangible right-to-use lease asset (a capital asset referred to as the lease asset). Amortization of the lease asset should be reported as an expense (example, amortization expense) which may be combined with depreciation expense related to other capital assets for financial reporting purposes.
Lessor (lease provider)	<ul style="list-style-type: none"> At the commencement of the lease term, a lessor should recognize a lease receivable, at the present value of payments expected to be received during the lease term less estimated uncollectible amounts, and a deferred inflow of resources, except for short-term leases and transfer or ownership. Over the lease term, the lessor recognizes revenue related to interest earned on the receivable and amortization of the deferred inflow of resources.



BACKGROUND - CONTINUED

Lease Accounting – Continued

All leases have a defined period in which the lessee maintains the right to use the lessor's non-financial asset, which is identified as the lease term. Each lease term has various components depending on the agreement reached between lessee and lessor. Once the lease term is determined, the initial lease liability and asset value are calculated, and an opening journal entry is recorded to recognize the asset or liability. As lease payments are made, subsequent journal entries are recorded to amortize the liability. These steps are detailed further below.



1. **Determine lease term.** The fixed, non-cancelable period for which a lease agreement is in force. According to the Government Finance Officers Association ("GFOA"), this term is comprised of, if applicable:
 - a. The non-cancelable periods;
 - b. Renewal option periods the lessee is reasonably certain of exercising;
 - c. Any periods covered by a termination option if reasonably certain the lessee will not exercise the option; and,
 - d. Periods from an option to extend (or not terminate) controlled by the lessor.



2. **Calculate the initial lease liability.** The lease liability is calculated as the present value of future lease payments during the lease term. The discount rate utilized, per GASB No. 87, should be the interest rate implicit within the lease. If that interest rate is not readily determined by the lessee, the lessee should use the estimated incremental borrowing rate.



3. **Calculate the initial lease asset value.** The lease asset value begins with the amount calculated as the lease liability. In addition to the present value of future lease payments, the asset value would include prepaid lease payments, less any lease incentives received from the lessor prior to the commencement of the lease term.



4. **Record the opening journal entry.** An initial journal entry should be applied to the general ledger to capture the inception of a new lease agreement.



5. **Record subsequent journal entries.** The leased asset should be amortized, reported as an outflow of resources, in a "systematic and rational manner" over the lesser of the lease term or useful life of the asset.



BACKGROUND - CONTINUED

GASB 87 Technical Accounting & Implications

GASB 87 is a significant change in lease accounting affecting nearly all governmental entities. The Financial Reporting & Control Accounting Division (“FRC”) within the County’s Finance Department, is responsible for maintaining the County’s books and records in accordance with Generally Accepted Accounting Principles (“GAAP”), and facilitating the annual audit of the County’s books and records as required by §15.2-2511 of the Code of Virginia. While FRC is responsible for preparing annual financial statements, GASB 87 will impact all County departments. The current requirements along with the key components of GASB 87 are as follows:

Component	Current Requirements	GASB 87 Requirements
Lease Classification	<p>There are currently two types of leases. Operating and capital (financing) leases.</p> <ul style="list-style-type: none"> • <i>Operating lease:</i> A rental of an asset from a lessor, but not under terms that transfer ownership of the asset to the lessee. • <i>Capital (financing) lease:</i> A lease in which the lessor only finances the leased asset, and all other rights of ownership transfer to the lessee. 	<p>Under GASB 87, leases will no longer be classified as operating or capital leases but will now be classified as “contracts that transfer ownership”, “short-term,” and “all other.”</p> <ul style="list-style-type: none"> • <i>Contracts that transfer ownership:</i> If the underlying asset transfers ownership to the lessee by the end of the contract, the transaction should be reported as a financed purchase of the underlying asset by the lessee, or sale of the asset by the lessor. • <i>Short-term leases:</i> Leases that have a maximum possible term of 12 months or less, including any options to extend. See the following page for detail on short-term leases. • <i>All other leases:</i> Any agreement that does not qualify as a short-term lease or ownership transfer contract will fall into this category, with implications for both lessees and lessors.
Financial Statement Reporting & Disclosure	<p>The current requirements allow a lease to be structured in a manner that avoids reporting the economic substance of the transaction. A long-term liability and related asset do not have to be reported because of the lease transaction.</p> <p>Operating leases are counted as off-balance sheet financing—meaning that a leased asset and associated liabilities of future rent payments are not included on a company’s balance sheet.</p>	<p>Financial statement disclosures and schedules will be required for contracts that transfer ownership and non-short-term leases.</p> <p>There will be no disclosure requirement for short-term lease outflows. These outflows will be accounted for using the cash basis and reflected on the income statement.</p> <p>Leases that extend beyond 12 months will have a balance sheet impact on both the lessee and lessor. The lessee will recognize the intangible use asset, and the lessor will continue to depreciate and account for the lease asset.</p>
Effective Date	<p>GASB 87 is effective for annual periods beginning after December 15, 2019. Changes adopted should also be applied retroactively by restating financial statements, if practicable, for all prior periods presented.</p> <p><i>Note: Due to the County’s fiscal year 2020 beginning on July 1, 2019 the new requirements will be in effect for fiscal year 2021.</i></p>	



BACKGROUND - CONTINUED

GASB 87 Technical Accounting & Implications - Continued

The County will need to adopt changes in various areas to prepare for GASB 87.



Policies and procedures updates related to...

1. Tracking and reporting leases both as lessees and lessors;
2. Documenting lease terms, options, and payment provisions;
3. Changes in a lease term, estimated lease payment amounts, or other components of lease agreements;
4. Asset capitalization; and,
5. Communication of the factors above, among others.



New technology to assist with...

1. Calculating future lease liability;
2. Separating lease & non-lease components for accounting purposes;
3. Tracking terms including renewals, options, expirations, etc.;
4. More comprehensive disclosure reporting; and,
5. Centralizing and storing lease information, processing payments and assisting in establishing controls over lease procurement.



Training to support...

1. Awareness across all departments of new requirements;
2. Communication of updates to policies and procedures;
3. Mindfulness of new technology; and,
4. Responsiveness to requests related to leases.

Exception to GASB 87 - Short Term Leases



Any lease defined as a short-term lease is not required to be presented on the balance sheet with all other lease agreements. Short-term leases will not be capitalized by the lessee or lessor, and lease revenues / expenses are accounted for on a cash basis.

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 or inflows of cash, respectively, based on the payment provisions of the lease contract.

Note: This exception is not a change from prior accounting standards. Short-term leases will continue to be accounted for in the current manner.



BACKGROUND

GASB 87 (Technical Accounting & Implications) - Continued

Embedded Leases

Certain arrangements that are not structured as leases may contain “embedded leases”. Embedded leases are components within contracts that entail the use of a particular asset, where the user has control over that asset. There are many areas in which an embedded lease may be found:



Information technology contracts
(e.g., servers)



Cable and satellite services
(e.g., set-top boxes)



Transportation and delivery services
(e.g., railcars)



Advertising
(e.g., billboards)



Contract manufacturing arrangements
(e.g., dedicated tooling)



Power purchase agreements
(e.g., power plants)



Complex service contracts
(e.g., specific equipment)



Joint-operating agreements
(e.g., drilling rigs)

Identifying embedded leases is an important part of compliance with GASB 87, as all leases are to be recorded on the balance sheet. A search for embedded leases should be included within a comprehensive implementation plan for preparing the County to comply with GASB 87.

Note: GASB 87 did not introduce a new requirement for identifying embedded leases, however, due to the enhanced presentation requirements it is critical for the County to capture all embedded leases for accurate presentation of agreements that transfer ownership.

Embedded Lease Example:

- Entity A enters into a service contract with Entity B for electricity from March through October for three years.
- Entity A makes fixed payments to obtain exclusive rights to electricity generated from Entity B’s turbine and to determine the nature and manner of how that electricity is used.
- This constitutes an embedded lease. GASB 87 states that a contract that conveys control of the right to use the underlying asset (turbine) for a period in addition to the right to the output generated by the underlying asset, then it meets the definition of a lease.



BACKGROUND - CONTINUED

Lease Financial Overview

The Comprehensive Annual Financial Report (“CAFR”) as of June 30, 2018, includes previously reported financial information related to the County’s investment in leases, along with notes and disclosures to provide additional context. The tables on this page illustrate the minimum lease payments related to the County’s operating¹ and capital² lease obligations, and the corresponding assets³ acquired through capital lease obligations.

Note: Under GASB 87, these figures will be restated in the FY 2021 financial statements due to the elimination of the operating lease classification.

Minimum Lease Commitments Operating Leases ¹ (in thousands)		Minimum Lease Commitments Capital Lease Obligations ² (in thousands)	
2019	\$ 6,899	2019	\$ 17,434
2020	6,282	2020	13,642
2021	5,905	2021	16,363
2022	4,653	2022	12,592
2023	4,070	2023	12,167
2024 – 2027	<u>9,652</u>	2024 - 2028	34,086
Total minimum lease payments	<u>\$ 37,461</u>	2029 - 2033	<u>4,404</u>
		Total minimum payments	\$ 110,688
		Less: interest	<u>(18,933)</u>
		Present value of future minimum payments	<u>\$ 91,755</u>

Assets Acquired Through Capital Lease Obligations ³ (in thousands)		
Other capital assets:	Governmental Activities	*ADC Component Unit
Buildings	\$ 91,537	\$ 6,459
Improvements	13,576	105
Machinery and equipment	2,072	-
Vehicles	1,413	-
Less: accumulated depreciation	<u>(45,646)</u>	<u>(4,478)</u>
Total assets acquired	<u>\$ 62,952</u>	<u>\$ 2,086</u>

*Adult Detention Center Component Unit



BACKGROUND - CONTINUED

Lease Financial Overview – Continued

Current lease standards include disclosure requirements intended to provide users of financial statements with additional information related to amount, timing and uncertainty of cash flows from leases. The following notes are included in the County's CAFR as of June 30, 2018.

Note/Disclosure	Detail
Operating and Capital Leases	The County leases real estate and equipment under operating and capital leases expiring at various dates through 2027. All leases are non-cancelable except they are contingent upon the BOCS appropriating funds for each year's payments. The County also has various short-term leases for real estate and equipment with initial or remaining non-cancelable lease terms of less than one year as of June 30, 2018. Total rental expense under operating leases of the primary government for the year ended June 30, 2018, was \$7,581.
Investment in Direct Financing Leases/Accounts Receivable	<p>The County has investments in direct financing leases, consisting of financing arrangements with various volunteer fire and rescue companies and other organizations operating within the County. Under the terms of these financing arrangements, the County obtains leasehold interests in specific properties, and uses those leasehold interests as collateral to obtain financing.</p> <p>The County uses the proceeds from these financings to reimburse the organizations for capital expenses related to the renovation or construction of facilities. In separate-but-related agreements, the County subleases the original leasehold interests and any existing and future improvements back to the organizations; each sublease contains a clause, which transfers title of the properties, as well as any existing and future improvements of the properties back to each respective organization at the time the related debt is fully extinguished.</p>

Note: GASB 87 includes enhanced quantitative and qualitative disclosure requirements for both lessees and lessors, which are detailed further on page 9.

The financial details of these agreements explained in the notes above are shown below. Exhibit 1 details the payments to be received by the County from the volunteer fire companies County for the minimum lease payments related to the sublease agreements. Exhibit 2 breaks down the minimum lease payments further, identifying the schedule of payments to be made by the volunteer companies over the ten-year period of FY 2019 through FY 2029.

Investment in Direct Financing Leases (at June 30, 2018) Volunteer Fire & Rescue Companies (in thousands)	
Total minimum lease payments to be received	\$ 9,997
Less: Deferred inflow of resources	<u>(1,637)</u>
Net investment in direct financing leases	<u>\$ 8,360</u>

Exhibit 1

Scheduled Minimum Lease Payments (at June 30, 2018) Volunteer Fire & Rescue Companies (in thousands)	
FY 2019	\$ 1,493
FY 2020	1,444
FY 2021	1,399
FY 2022	1,360
FY 2023	1,318
FY 2024 - 2028	2,768
FY 2029	<u>215</u>
Total minimum lease payments	<u>\$ 9,997</u>

Exhibit 2



BACKGROUND - CONTINUED

Lease Financial Overview – Continued

Lease and rental expenditures correspond to payment for property and goods related lease and rental agreements. See below for actual and projected lease and rental expenditures included in the County's FY 2020 budget document.

The Department of Public Works accounts for roughly 77% of all expenditures due to their oversight of the leases of county buildings. The remaining expenditures primarily stem from leases for vehicles (police and adult detention center) and office space use.

Fiscal Year	Expenditures (Leases and Rentals)
FY 2016 (Actual)	\$8,319,868
FY 2017 (Actual)	\$8,890,788
FY 2018 (Actual)	\$9,387,409
FY 2019 (Adopted)	\$10,429,564
FY 2020 (Adopted)	\$10,053,802

Department	FY 2016 (Actual)	FY 2017 (Actual)	FY 2018 (Actual)	FY 2019 (Adopted)	FY 2020 (Adopted)	Total
Public Works	\$6,513,416	\$7,032,916	\$7,357,523	\$7,968,156	\$7,569,618	\$36,441,629
Police	\$430,228	\$468,648	\$557,035	\$593,868	\$554,540	\$2,604,319
Adult Detention Center	\$281,874	\$280,700	\$295,640	\$283,200	\$283,200	\$1,424,614
Economic Development	\$251,146	\$267,618	\$275,275	\$271,707	\$271,707	\$1,337,453
Fire & Rescue	\$222,293	\$183,476	\$166,957	\$331,017	\$348,585	\$1,252,328
Community Services	\$147,694	\$159,693	\$172,323	\$196,274	\$177,206	\$853,190
Parks, Recreation & Tourism	\$72,157	\$96,374	\$136,298	\$228,725	\$238,205	\$771,759
Social Services	\$66,655	\$58,923	\$72,684	\$95,694	\$96,694	\$390,650
Library	\$49,418	\$49,636	\$55,394	\$54,912	\$73,200	\$282,560
Finance	\$38,878	\$35,605	\$21,964	\$47,284	\$47,284	\$191,015



OBJECTIVES AND APPROACH

Objectives

GASB 87 is a new reporting requirement for the County for FY 2021, as such the primary objective of this analysis was to assist the County in its proactive compliance efforts by performing an assessment of its operating lease environment and to provide guidelines for implementation. In addition, we assisted the County in accumulating and analyzing its readiness for print/copier managed services.

The scope of this project encompassed known active leases across the County as of June 30, 2019.

Approach

Our approach consisted of the following phases:

Understanding and Assessment of the Process

During this phase of this analysis we conducted interviews with the appropriate representatives from the Department of Finance to discuss the scope and objectives of the audit work, obtain preliminary data, and establish working arrangements. We obtained and reviewed 1) copies of financial information; 2) applicable Code of Virginia and County policies related to this internal audit and 3) other documents deemed necessary; and performed walkthroughs of the process(es) and key controls to gain an understanding of the function and assess the design of the process/key controls.

Procedures included the following:

- Reviewed the current process that the County uses to identify, record, and track all operating lease arrangements, including accounting and financial reporting;
- Assessed readiness in adopting and implementing new GASB 87 lease accounting rules;
- Accumulated various printer and copier agreements utilized across the County through distribution of a survey regarding lease awareness among personnel;
- Assessed if the records and documentation for operating leases are sufficient to establish an audit trail for the completeness of tracking and recording of leases;
- Reviewed a sample of active leases related to print management services and identify possible cost savings measures;
- Identified opportunities for cost reduction and efficiency within printer and copier management; and
- Provided recommendations for process improvements.

Reporting

At the conclusion of this audit, we summarized the results of our readiness analysis into this report. We conducted an exit meeting with the appropriate Management.



APPENDIX A - SAMPLE RISK & CONTROL MATRIX

GASB 87 - Sample Risk and Control Matrix (RACM)			
Control	Risk	Subprocess	Control Activity
GASB.01	Leases and their appropriate classification are not identified within contracts (i.e. embedded leases) which may result in unrecognized lease accounting.	Lease administration and accounting	On a per event basis, new contracts are reviewed to determine if they contain a lease per GASB 87. The rationale for the determination is documented including all relevant criteria for classifying the lease and thresholds used in the evaluation.
GASB.02	Modifications that represent a new contract are not properly identified, assessed, and accounted for. Lease classification is incorrect as a result of contract modification.	Lease administration and accounting	On a per event basis, contract modifications to existing leases are reviewed to determine if the modifications represent a new lease under GASB 87. The rationale for the determination is documented including the evaluation of lease classification under GASB 87.
GASB.03	Gain/Loss is not recognized. The carrying value of assets is misstated.	Lease administration and accounting	On a per event basis, termination of contracts that contain leases are reviewed in the context of GASB 87. The rationale for the accounting treatment is documented including gain/loss treatment and/or adjusted carrying values.
GASB.04	The adoption of the new lease standard is not complete or is not completed timely.	Adoption	The GASB 87 Project Plan is presented quarterly by the [appropriate personnel] to the [appropriate personnel] to ensure evaluation of the standards full impact on financial reporting. The project plan includes: identification and review of leases, classification, planned retrospective application, financial statement presentation, and required disclosures. The [appropriate personnel] reviews and validates that all major steps in the project plan are on track, that relevant completeness procedures are being performed timely, and that issues are captured. Evidence of review is comments provided to the [appropriate personnel] within the plan or documented notes.
GASB.05	Treatment of a portfolio of leases or individual lease is incorrect resulting in incorrect financial statements. All leases pertaining to the County are not evaluated under the new standard.	Adoption	The [appropriate personnel] reviewed and approved the population of leases that were included in the retrospective adoption approach and verified that the population was complete within the scope and guidance of GASB 87, which was evidenced via sign off on County-wide lease summary.
GASB.06	Treatment of a portfolio of leases or individual leases is incorrect resulting in incorrect financial statements.	Adoption	The [appropriate personnel] reviewed the evaluation performed by the [appropriate personnel] on the in-scope leases to verify the conclusions were in accordance with GASB 87. This review was evidenced via sign-off and other documentary evidence (e.g., tick marks, notes, comments, etc.) on the individual contract analysis tools.
GASB.07	Treatment of a portfolio of leases or individual leases is incorrect resulting in incorrect financial statements. All leases pertaining to the County are not evaluated under the new standard.	Adoption	The [appropriate personnel] compares the lease expense calculated within the data collection tool used to populate all identified leases to the County's recorded lease expense. The [appropriate personnel] reviews the reconciliation and investigates any significant differences. Evidence of review is sign-off and documented summary of differences on the reconciliation



APPENDIX A - SAMPLE RISK & CONTROL MATRIX – CONTINUED

GASB 87 - Sample Risk and Control Matrix (RACM)			
Control	Risk	Subprocess	Control Activity
GASB.08	Treatment of a portfolio of leases or individual leases is incorrect resulting in incorrect financial statements. All leases pertaining to the County are not evaluated under the new standard.	Adoption	The [appropriate personnel] compares the recorded leased assets to the calculated lease assets within the data collection tool used to populate all identified leases. The [appropriate personnel] reviews the reconciliation and investigates any significant differences. Evidence of review is sign-off and documented summary of differences on the reconciliation.
GASB.09	All leases pertaining to the County are not evaluated under the new standard.	Adoption	Quarterly, the [appropriate personnel] distributes a certification form to all business unit leads requesting certification that all lease agreements have been communicated to the accounting department. The [appropriate personnel] collects signed certification from each business unit leader. Evidence of control performance is a complete inventory of all certifications signed by all applicable business owners.
GASB.10	Leases are not identified within contracts (i.e. embedded leases) which may result in unrecognized off balance sheet transactions.	Adoption	The [appropriate personnel] identifies categories of arrangements to investigate for embedded leases by summarizing arrangement types along the County's supply-chain and reviewing recurring payment schedules. Arrangement categories are summarized into the County's scoping document for the adoption of GASB 87. The [appropriate personnel] reviews the categories and supporting workpapers with the [appropriate personnel]. Evidence of review is sign-off on the supporting workpapers or scoping memo.
GASB.11	Leases are not identified within contracts (i.e. embedded leases) which may result in unrecognized off balance sheet transactions.	Adoption	The [appropriate personnel] reviews a representative sample of service arrangements in each defined service category to determine if arrangements include embedded leases. A position paper summarizing the evaluation process and conclusions is completed upon review of the arrangements. The [appropriate personnel] reviews the position paper summarizing the conclusions against both GASB-840 and GASB-87 guidance and obtaining third-party opinion as-needed. Evidence of review is draft notes of the position papers and final approval sign-off or email by the [appropriate personnel].
GASB.12	Lease accounting information obtained through a lease accounting software and relied upon by management is incomplete, inaccurate, and/or improperly presented due to the third-party providers ineffective IT controls.	Disclosure	The [appropriate personnel] requests a System and Organization Control (SOC) 1 report, Type 2 report from the County's lease accounting software vendor on a semi-annual basis. The Director of Technical Accounting reviews the report opinion and complementary user controls and maps those controls to the County's own internal control environment. Any deficiencies identified are mapped to compensating controls or tested for further validation by the County. Evidence of review is documentation on the SOC 1, Type 2 questionnaire maintained.
GASB.13	New leases are not valued correctly considering critical judgments or estimates utilized in the calculation.	Lease administration and accounting	Upon entry into a new contract that contains a lease, the technical accounting director evaluates all relevant estimates including but not limited to stand alone selling prices, discount rates, and estimated useful lives for appropriateness. Key assumptions and sources for estimates used are documented and tied to relevant source documentation. The [appropriate personnel] reviews assumptions and estimates used for completeness, and adequate valuation evidenced by comments within the source documentation.



APPENDIX B - SAMPLE IMPLEMENTATION PLAN

Major Project Phase	Step	Project Sub-step	Timeline		
			Start Date	End Date	Status
01 Project initiation					
Initiation and planning	01.01	Identify project team			Not Started
Initiation and planning	01.02	Tailor project plan			Not Started
Initiation and planning	01.03	Conduct formal kick-off meeting			Not Started
Initiation and planning	01.04	Establish overall project timeline			Not Started
Initiation and planning	01.05	Establish resources aligned to project			Not Started
Business requirements and contracts	01.06	Identify existing lease accounting systems and tools			Not Started
Business requirements and contracts	01.07	Identify existing lease accounting spreadsheet(s)			Not Started
Business requirements and contracts	01.08	Identify location(s) of existing leases documents			Not Started
Business requirements and contracts	01.09	Document current process for initiating and accounting for existing			Not Started
Initiation and planning	01.10	Estimate pro forma budget			Not Started
Initiation and planning	01.11	Establish internal status reporting and communications			Not Started
Initiation and planning	01.12	Establish reporting to Executive Management			Not Started
Initiation and planning	01.13	Establish reporting to Audit Committee			Not Started
Initiation and planning	01.14	Assign responsibilities to resources			Not Started
Initiation and planning	01.15	Prepare a documentation request list			Not Started
Initiation and planning	01.16	Distribute lease questionnaire to identified resources			Not Started
Initiation and planning	01.17	Assess impact of practical expedient			Not Started
Initiation and planning	01.18	Conclude on application of practical expedient			Not Started
Initiation and planning	01.19	Develop GASB 87 Scoping/Approach Memo (Completeness and			Not Started
Initiation and planning	01.20	Develop GASB 87 Scoping/Approach Memo (Completeness and			Not Started
02 Lease identification and categorization by level of effort					
Business requirements and contracts	02.01	Establish in scope lease categories			Not Started
Business requirements and contracts	02.02	Inventory the organization for all leases			Not Started
Business requirements and contracts	02.03	Establish Financing vs Operating criteria			Not Started
Business requirements and contracts	02.04	Sample data collection and input into DCT (estimated sample of 8)			Not Started
Business requirements and contracts	02.05	Establish level of effort categories (e.g. 1,2, 3) for data collection			Not Started
Business requirements and contracts	02.06	Estimate hours for data collection and DCT input for each level of			Not Started
Business requirements and contracts	02.07	Establish overall resource requirements for data collection and DCT			Not Started
Business requirements and contracts	02.08	Evaluate a sample of leases to support defined impact of 87 to			Not Started



APPENDIX B - SAMPLE IMPLEMENTATION PLAN – CONTINUED

Major Project Phase	Step	Project Sub-step	Timeline		
			Start Date	End Date	Status
03 Data Extraction					
Business process and system design	03.01	Document assumptions required for calculations			Not Started
Business process and system design	03.02	Determine data needed for calculations			Not Started
Business process and system design	03.03	Develop Data Collection Template (DCT)			Not Started
Configuration and lease abstraction	03.04	Input existing leasing information into DCT			Not Started
Define 87 impact	03.05	Draft proforma disclosures and identify relevant data			Not Started
Business process and system design	03.06	Define roles and responsibilities for data collection			Not Started
Configuration and lease abstraction	03.07	Establish lease repository			Not Started
Configuration and lease abstraction	03.08	Obtain all existing leasing information			Not Started
Configuration and lease abstraction	03.09	Cleansing and enrichment of lease data			Not Started
04 Completeness control over lease identification					
Deployment and adoption	04.01	Workshop to increase awareness of individuals responsible for			Not Started
Configuration and lease abstraction	04.02	Compare lease expense from DCT to recorded lease expense			Not Started
Configuration and lease abstraction	04.03	Compare recorded leased assets to DCT calculated amounts			Not Started
Configuration and lease abstraction	04.04	Compare 2019 future lease payments disclosure to DCT amount			Not Started
Configuration and lease abstraction	04.05	Analyze significant differences			Not Started
Business requirements and contracts	04.06	Certification of lease population from agreement owners/plant			Not Started
05 Data validation					
Testing and validation	05.01	Establish sampling criteria and confidence levels			Not Started
Testing and validation	05.02	Import data into lease validation template			Not Started
Testing and validation	05.03	Review leases in template for errors			Not Started
Testing and validation	05.04	Evaluate results (determine if expected error rate has been			Not Started
Testing and validation	05.05	Resample if actual error rate exceeds expected error rate			Not Started
Testing and validation	05.06	Investigate differences			Not Started
06 Embedded leases					
Business requirements and contracts	06.01	Establish leases vs services criteria			Not Started
Business requirements and contracts	06.02	Establish categories for arrangements at risk for embedded contracts			Not Started
Business requirements and contracts	06.03	Gather all Contract/Services expense by type			Not Started
Business requirements and contracts	06.04	Disqualify certain categories that will not contain embedded leases			Not Started
Business requirements and contracts	06.05	Review arrangements/contracts for embedded leases			Not Started
Business requirements and contracts	06.06	Identify arrangements requiring follow-on facts			Not Started
Business requirements and contracts	06.07	Obtain follow-on "on the ground" facts for identified			Not Started
Define 87 impact	06.08	Prepare position paper covering arrangements/contracts at medium			Not Started
Business requirements and contracts	06.09	Identify embedded leased assets within arrangements/contracts			Not Started
Configuration and lease abstraction	06.10	Capture embedded lease data			Not Started
Configuration and lease abstraction	06.11	Allocate contract consideration between embedded lease and other			Not Started
Configuration and lease abstraction	06.12	Input embedded lease into DCT			Not Started



APPENDIX B - SAMPLE IMPLEMENTATION PLAN – CONTINUED

Major Project Phase	Step	Project Sub-step	Timeline		
			Start Date	End Date	Status
07 Completeness control - embedded leases identification					
Deployment and adoption	07.01	Workshop to increase awareness of individuals responsible for			Not Started
Configuration and lease abstraction	07.02	Analyze significant differences			Not Started
Configuration and lease abstraction	07.03	Additional steps to be determined			Not Started
08 Data validation - embedded leases					
Testing and validation	08.01	Establish sampling criteria and confidence levels			Not Started
Testing and validation	08.02	Import data into arrangement validation template			Not Started
Testing and validation	08.03	Review arrangements in template for errors			Not Started
Testing and validation	08.04	Evaluate results (determine if expected error rate has been			Not Started
Testing and validation	08.05	Resample if actual error rate exceeds expected error rate			Not Started
Testing and validation	08.06	Investigate differences			Not Started
09 Impact assessment on prior reporting for new leases identified					
Testing and validation	09.01	Steps to be determined			Not Started
Testing and validation	09.02	Steps to be determined			Not Started
10 Proforma GASB 87 calculations					
Define 87 impact	10.01	Develop GASB 87 Calculation Template			Not Started
Define 87 impact	10.02	Prepare position paper to conclude on impact assessment			Not Started
Define 87 impact	10.03	Project impact on Balance Sheet, Ratios and Covenants			Not Started
11 Future leases					
Business process and system design	11.01	Establish process for identification of future leases			Not Started
Business process and system design	11.02	Establish future lease vs services criteria			Not Started
Business process and system design	11.03	Develop and document new policies, procedures, roles and			Not Started
Business process and system design	11.04	Develop policies and procedures for the identification of embedded			Not Started
Business process and system design	11.05	Establish leases vs. services contract best practices			Not Started
Deployment and adoption	11.06	Develop training on GASB 87			Not Started
Deployment and adoption	11.07	Conduct training on GASB 87			Not Started
12 Lease system identification					
Develop operational and technology	12.01	Develop lease system requirements			Not Started
Develop operational and technology	12.02	Evaluate business requirements against viable technology vendors			Not Started
Develop operational and technology	12.03	Determine operating environment requirements			Not Started
Develop operational and technology	12.04	System selection			Not Started
13 Lease system initiation and establishment					
Business process and system design	13.01	Develop detailed system design plan			Not Started
Configuration and lease abstraction	13.02	Configure system to receive lease data and future lease requirements			Not Started
Configuration and lease abstraction	13.03	Transfer data into lease system			Not Started
Testing and validation	13.04	Validate and test data in system staging			Not Started
Configuration and lease abstraction	13.05	Perform quality control over shift to GASB 87 calculations			Not Started
14 GASB 87 lease policies and disclosures					
Business process and system design	14.01	Develop GASB 87 Accounting Policies			Not Started
Deployment and adoption	14.02	Develop lease disclosures			Not Started



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