

Accounting Entries Related to Debt

2019 Spring WGFOA Conference
Elkhart Lake, WI



WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING

Investment advisory services are offered through CliftonLarsonAllen Wealth Advisors, LLC, an SEC-registered investment advisor



Create Opportunities

Objectives

- Comply with the requirements of generally accepted accounting principals (U.S. GAAP) related to accounting and financial reporting for debt.
 - Basic accounting for debt issuance
 - Reporting characteristics of debt transactions within the reporting entity (government-wide; fund financial statements)

Debt Characteristics

- Purpose (highway, building, equipment, utilities)
- Security/source of repayment
 - General obligation: Full faith and credit of issuer pledge
 - Revenue: Pledge specific revenues
 - BAN or NAN: Future borrowings
- Tax status (taxable or tax-exempt)
- Interest rate (Is debt issued at a premium or discount?)
- Term (long or short-term)

Basic Accounting for Debt

- Short-term debt
 - BAN, NAN, TAN, RAN, GAN
- Long-term debt
 - Identify projects funded by debt
 - Recognize distinction between fund liabilities and general long-term liabilities
 - Governmental vs. proprietary funds
 - ◇ When do you report general obligation debt in a proprietary fund?



Basic Accounting for Debt

- Current financial resources measurement focus
 - Governmental funds
 - Other financing sources (uses)
 - ◇ Premiums & discounts reported separately from proceeds
 - Debt service expenditure – debt issuance costs
- Economic resources measurement focus
 - Government-wide; proprietary and fiduciary funds
 - Similar to private-sector, except for debt issuance costs

Basic Accounting for Debt

- Interfund advances
 - Blended Component Unit and Other Funds
 - ◇ Record as fund liabilities in governmental funds
 - Discretely presented component unit
 - ◇ Other financing sources

Bond Refunding

- **Current Refunding:** This is where the new bond replaces the old bond within 90 days.
 - Debt service – principal reported in other financing uses
- **Advanced Refunding:** Occurs when proceeds from new debt issue is placed in an escrow account until the old bonds mature and can be paid off.
 - Tax Cut and Jobs Act of 2017 (TCJA) removed the tax exemption from advance refunding of municipal bonds.

Closing Memorandum

- When issuing debt, your financial advisor will often provide you with a “Closing Memorandum.”
- Document you will most likely use to make your journal entries to record the debt.
- Dated (issue) date and closing date identified





Example – General Obligation

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Key Calculations from a Debt Sale – Available Funds

Calculation of Available Funds

Par Amount of the Notes		\$1,960,000.00
Plus: Reoffering Premium		<u>121,156.35</u>
ISSUE PRICE/GROSS PRODUCTION		\$2,081,156.35
Less: Underwriter's Discount		<u>(11,640.89)</u>
PURCHASE PRICE		\$2,069,515.46
TOTAL AVAILABLE FUNDS		\$2,069,515.46
Less: Costs of Issuance ¹		
Ehlers (Municipal Advisor)	\$19,900.00	
Quarles & Brady LLP (Bond Counsel)	9,000.00	
Quarles & Brady LLP (Disclosure Counsel)	5,850.00	
Moody's Investors Service (Rating Agency)	<u>12,500.00</u>	
Total Costs of Issuance		<u>(47,250.00)</u>
NET AVAILABLE FUNDS		<u>\$2,022,265.46</u>

Debt Issuance Costs

- Direct Costs of Issuance
 - Costs paid indirectly by the issuer for services relating to selling the debt to investors and managing elements of the transaction.
- Underwriter's Discount
 - Costs paid indirectly by the issuer to the underwriter of the bonds for services relating to selling the bonds to investors and managing elements of the transaction.
- GASB No. 65
 - Debt issuance costs, except any portion related to prepaid insurance costs, should be recognized as an expense in the period incurred.



Debt Discounts and Premiums

- Discounts or premiums
 - Occurs when stated interest rate is higher (premium) or lower (discount) than current prevailing interest rates (market requirements) when the debt sold
- Governments should report the *face amount* of the debt as an “other financing source” and report a premium or discount as a second “other financing source/use.”

Key Calculations from a Debt Sale - Debt Premium

Maturity Date	Principal Amount at Issuance	Security Description	Coupon	Price	Yield	Debt Premium
3/1/2021	\$ 235,000	PROM NTS-SER A	5.00%	106.465	1.85%	\$ 15,192.75
3/1/2022	170,000	PROM NTS-SER A	5.00%	109.137	1.95%	15,532.90
3/1/2023	230,000	PROM NTS-SER A	4.00%	107.634	2.05%	17,558.20
3/1/2024	225,000	PROM NTS-SER A	4.00%	108.893	2.15%	20,009.25
3/1/2025	275,000	PROM NTS-SER A	4.00%	109.925	2.25%	27,293.75
3/1/2026	275,000	PROM NTS-SER A	3.00%	103.674	2.35%	10,103.50
3/1/2027	275,000	PROM NTS-SER A	3.00%	103.098	2.45%	8,519.50
3/1/2028	275,000	PROM NTS-SER A	3.00%	102.526	2.55%	6,946.50
	<u>\$ 1,960,000</u>					<u>\$ 121,156.35</u>

Key Calculations from a Debt Sale – Use of Funds

Distribution of Available Funds

	<u>Note Proceeds</u>	<u>Total</u>
Deposit to Borrowed Money Fund		
Note Proceeds	\$1,912,750.00	
Total Deposit to Borrowed Money Fund		\$1,912,750.00
Deposit to Debt Service Account ²		
Bid Premium Deposit to Debt Service	70,515.73	
Capitalized Interest	38,999.73	
Total Deposit to Debt Service Account		109,515.46
TOTAL FUNDS RECEIVED BY THE VILLAGE	\$2,022,265.46	
TOTAL DISTRIBUTION OF AVAILABLE FUNDS		<u>\$2,022,265.46</u>

Key Calculations from a Debt Sale – Project Costs

Summary of Funds Available for Financing Project Costs

<i>Source of Funds</i>	<i>Amount</i>
Note Proceeds Deposited to Borrowed Money Fund	\$1,912,750.00
Estimated Interest Earnings on Borrowed Money Fund	<u>3,361.00</u>
<i>Total Funds Available for Financing Project Costs</i>	\$1,916,111.00
<i>Use of Funds</i>	<i>Amount</i>
Public Works Equipment	\$80,721.00
Streets, Parks, Fire & EMS Projects	1,635,390.00
Water Projects	<u>200,000.00</u>
<i>Total Uses</i>	\$1,916,111.00

Key Calculations from a Debt Sale – Allocation

Total Issue Sources And Uses

		Equipment (5 years)	Streets (10 year)	Water	Total
Sources Of Funds					
Par Amount of Bonds	{1}	85,000.00	1,665,000.00	210,000.00	1,960,000.00
Reoffering Premium	{2}	6,807.50	100,228.50	14,120.35	121,156.35
Est, Interest earnings	{3}	145.75	2,855.14	360.11	3,361.00
Total Sources		91,953.25	1,768,083.64	224,480.46	2,084,517.35
Uses Of Funds					
Total Underwriter's Discount (0.594%)	{4}	504.83	9,888.82	1,247.24	11,640.89
Costs of Issuance	{5}	2,049.09	40,138.40	5,062.51	47,250.00
Deposit to Capitalized Interest (CIF) Fun	{6}	2,290.56	36,709.17	-	38,999.73
Deposit to Project Construction Fund	{7}	79,000.00	1,635,390.00	200,000.00	1,914,390.00
Bid Premium dep to ds	{8}	4,012.11	53,630.51	12,873.11	70,515.73
Rounding Amount	{9}	4,096.66	(7,673.26)	5,297.60	1,721.00
Total Uses		91,953.25	1,768,083.64	224,480.46	2,084,517.35
Variance		-	-	-	-

Sample Journal Entry

Adjusting Journal Entry - To record Series 2019A

				<u>Debit</u>	<u>Credit</u>
Debt Service Fund	Other financing source	Proceeds From Bonds	{6}		38,999.73
Debt Service Fund	Other financing source	Premium On Debt Issuance	{8}		57,642.62
Debt Service Fund	Asset	Debt Service Checking	{6 + 8}	96,642.35	
Capital Projects Fund	Other financing source	Proceeds From Bonds	{1 - 6}		1,711,000.27
Capital Projects Fund	Other financing source	Premium on Debt Issuance	{2 - 8}		49,393.38
Capital Projects Fund	Expenditure	Debt Issuance Costs	{4 + 5}	52,581.14	
Capital Projects Fund	Asset	Capital Borrowing Checking	{7 + 9 - 3}	1,707,812.51	
Water Utility	Asset	Checking Account	{7 + 9 - 3}	204,937.49	
Water Utility	Asset	Cash - Debt Service	{8}	12,873.11	
Water Utility	Fund Liability	2019 GO Bonds	{1}		210,000.00
Water Utility	Fund Liability	Premium on Debt Issuance	{8}		14,120.35
Water Utility	Expense	Debt Issuance Costs	{4 + 5}	6,309.75	
				<u>2,081,156.35</u>	<u>2,081,156.35</u>
Total Cash				<u>2,022,265.46</u>	
				- Agrees with closing statement	



Example - Revenue Bonds

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Sources and Uses of Revenue Bonds (Refunding)

Sources of Funds

Par Amount of Bonds	\$10,365,000.00
Transfer from Outstanding Bonds Reserve Account	6,303,062.50
Reoffering Premium	681,481.65
Estimated Investment Earnings	29,768.75
Total Sources	<u>\$17,379,312.90</u>

Uses of Funds

Deposit to Current Refunding Fund	\$10,825,000.00
Deposit to Reserve Account	6,299,093.75
Cost of Issuance (including Underwriter's Discount) and Rounding	255,219.15
Total Uses	<u>\$17,379,312.90</u>

Sample Journal Entry – Revenue Bonds (Refunding)

		<u>Debit</u>	<u>Credit</u>
Assets	Restricted Cash - Bond Reserve		6,303,063
Assets	Restricted Cash - Bond Reserve	6,269,326	
Deferred inflow	Refunding		85,000
Fund Liability	2014 Revenue Bonds	10,825,000	
Fund Liability	2019 Revenue Bonds		10,365,000
Fund Liability	Premium on Debt Issuance - 2014 Bonds	85,000	
Fund Liability	Premium on Debt Issuance - 2019 Bonds		681,482
Expense	Debt Issuance Costs	255,219	
		<u>28,947,112</u>	<u>28,947,112</u>

Sources and Uses of Revenue Bonds (New Projects)

Sources and Applications of Funds

Sources of Funds

Par Amount of Bonds	\$ 11,150,000
Net Reoffering Premium	<u>362,567</u>
Total	<u>\$ 11,512,567</u>

Applications of Funds

Project Costs	\$ 10,449,032
Deposit to Reserve Account	700,968
Costs of Issuance (including Underwriter's Discount and Bond Insurance Premium)	337,567
Capitalized Interest	<u>25,000</u>
Total	<u>\$ 11,512,567</u>

Sample Journal Entry – Revenue Bonds (New Projects)

Impact of bond reserve

		<u>Debit</u>	<u>Credit</u>
Assets	Project Cash	10,449,032	
Assets	Restricted Cash - Bond Reserve	700,968	
Assets	Restricted Cash - Capitalized interest	25,000	
Fund Liability	2019 Revenue Bonds		11,150,000
Fund Liability	Premium on Debt Issuance		362,567
Expense	Debt Issuance Costs	337,567	
		<u>11,512,567</u>	<u>11,512,567</u>

Revenue Bond Ordinances

- Review documentation of bond issue
- Revenue bond ordinance
 - Authorization to issue debt by governing body
 - Establish government's responsibilities
 - ◇ Restricted cash funds
 - ◇ Covenants

Revenue Bonds – Flow of Resources



O&M Fund

- Current expenses



Special Redemption & Reserve

- Principal (1/12)
- Interest (1/6)
- Reserve deficiencies



Depreciation

- Capital expenditures

Restricted Cash - Special Redemption Fund

- Deposit 1/12th of principal; 1/6th of interest

Payment			Debt Payments		Deposits			Cash
Date	Month	Year	Principal	Interest	Principal	Interest	Total	Balance
11/1/2018	November	2018	330,000.00	15,981.25	28,333.33	1,975.00	30,308.33	30,308.33
	December	2018			28,333.33	1,975.00	30,308.33	60,616.66
	January	2019			28,333.33	1,975.00	30,308.33	90,924.99
	February	2019			28,333.33	1,975.00	30,308.33	121,233.32
	March	2019			28,333.33	1,975.00	30,308.33	151,541.65
	April	2019			28,333.33	1,975.00	30,308.33	181,849.98
5/1/2019	May	2019	-	11,850.00	28,333.33	1,975.00	30,308.33	200,308.31
	June	2019			28,333.33	1,975.00	30,308.33	230,616.64
	July	2019			28,333.33	1,975.00	30,308.33	260,924.97
	August	2019			28,333.33	1,975.00	30,308.33	291,233.30
	September	2019			28,333.33	1,975.00	30,308.33	321,541.63
	October	2019			28,333.37	1,975.00	30,308.37	351,850.00
11/1/2019	November	2019	340,000.00	11,850.00	20,416.67	1,250.00	21,666.67	21,666.67

Revenue Bond Disclosures

- Key documentation items
 - Pledged revenue footnote
- Is revenue bond reserve reported as restricted net position?
 - If funded from debt proceeds, should reduce capital related debt in the determination of *Net Investment in Capital Assets*



Post-debt Issuance Accounting entries and disclosures

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Monitoring Debt Proceeds

- How do you monitor post-issuance debt proceeds
 - Segregating debt service and project funds
 - ◇ What happens if you spend debt reserves?
 - Tracking unspent debt proceeds (projects vs. actual expenditures)
 - ◇ Debt proceeds are restricted for use
 - ◇ Restricted fund balance versus net position
 - Arbitrage monitoring



Accumulating Resources for Debt Repayment - Governmental Funds

- Debt service fund generally used to accumulate financial resources that are restricted, committed, or assigned for debt service payments:
 - Property taxes levied specifically for debt service
 - Other revenues (special assessments, etc.)
 - Transfers from other funds (TIF Districts)
 - Amounts deducted from debt proceeds
 - Interest and other investment revenue earned on the accumulated resources

Accumulating Resources for Debt Repayment - Proprietary Funds

- Restricted cash accounts:
 - User charges segregated for debt retirement
 - Impact fees
 - Amounts deducted from debt proceeds
- Other revenues:
 - Special assessments

Debt Discounts and Premiums

- GASB No. 62
 - Discount or premium to be amortized as interest expense over the life of the debt using the “interest” method.
 - In practice, most governments use straight-line amortization
- Unamortized discounts and premiums reported as a deduction from or addition to the face amount of the debt.

Converting Governmental Funds to Government – Wide Conversion Entry

Account	Debit	Credit
Other financing sources – debt proceeds	\$1,750,000	
Debt service expenditure - principal		75,000
Current liabilities – Long-term debt		100,000
Long-term liabilities		1,575,000
Total	\$1,750,000	\$1,750,000



Converting Governmental Funds to Government – Wide Conversion Entry

Account	Debit	Credit
Other financing sources – bond premium	\$107,036	
Debt premium		98,136
Interest expense (estimated amortization)		8,900
Total	\$107,036	\$107,036

Converting Governmental Funds to Government – Wide Conversion Entry

Account	Debit	Credit
Interest expense	\$17,500	
Accrued interest		17,500
Total	\$17,500	\$17,500

Interest Detail	Amount
Interest paid	\$32,700
Interest accrued	17,500
Premium amortization	(8,900)
Issuance costs	52,581
Government-wide Expense	\$93,881



Upcoming GASB Pronouncements

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GASB No. 87, *Leases*

- Effective Date
 - For reporting periods beginning after December 15, 2019
- Establishes a single approach to accounting for leases that will eliminate the current operating and capital lease classifications

Lessee Accounting under GASB No. 87

- Recognize lease liability/ intangible asset at the beginning of a lease
- Lease liability measured at present value of lease payments over the lease term
- Intangible asset measured at the value of the lease liability plus prepayments, if applicable
- Lease liability reduced as payments are made
- Interest is accrued on lease liability
- Intangible asset amortized to expense over shorter of the life of the underlying asset or the lease term



GASB No. 88, Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements

- Effective Date
 - For reporting periods beginning after June 15, 2018
- Clarifies which liabilities governments should include in their note disclosures related to debt.





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