

## TYPES OF DEBT REPORTS AND FORMS

Debt records should be kept for each debt issue. A complete transcript for each issue is normally provided by Bond Counsel to the Issuer<sup>1</sup> shortly after the bond closing. The transcript includes the necessary documents required for administering and accounting for the debt issue. Documents containing information which will be regularly used over the life of the issue are:

- Schedules of future debt service,
- Paying Agent/Registrar data,
- Tax Certificate, and the
- Escrow agreement (typically for advance refundings).

While the Paying Agent is required to provide an invoice to the Issuer prior to a debt service payment date pursuant to the paying agent agreement, it is the Issuer's responsibility to ensure that accurate and timely payment is made to the Paying Agent according to the bond documents. Sometimes payments are required to be made well in advance of the payment date due to requirements of credit enhancers such as bond insurers, the State of Oregon [School Bond Guaranty Program](#), or bond covenants.

For each debt issue, records are required for:

1. Efficient administration during the period the debt is outstanding,
2. External financial reporting purposes, and
3. Budgeting purposes.

## DEBT ACCOUNTING & REPORTING

### ***Bond Accounting***

When bonds are issued for general government purposes, the proceeds are recorded in governmental funds. This may be in the general fund, a special revenue fund or, if the debt is to be used for capital construction, a capital projects fund. The obligation for the debt is recorded separately from the governmental type funds for reporting purposes. When debt is issued for proprietary funds, both the proceeds and the obligation for the debt are recorded in the fund itself.

The face amount of debt, Underwriter's discount, original issue discount and premium, and cost of issuance must all be separately recorded in the accounting records. It is not appropriate to record only the net amount of cash received.

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<sup>1</sup> The term "Issuer" is a general reference to issuing districts, municipalities, and local governments.

The official bond documents for Revenue Bonds and certain other types of debt may require that the government establish a debt service reserve fund, which provide a financial cushion for any periods in which net revenues are not sufficient to pay debt service on the bonds. If such funds are not drawn upon previously, they may be used for the payment of debt service near the end of the life of the issue. Those reserves generally will be held in a separate fund. Direct recording of the proceeds or intrafund transfers are used to record the required reserve amount from the fund holding the proceeds into the fund where the reserve will be held.

Deferred costs such as issuance costs and Underwriter's discounts are amortized over the life of the debt issue using a systematic and rational method. Original issue premium and discounts are also amortized. Amortization is recorded in the proprietary fund for proprietary fund obligations. Amortization of original premiums and discounts for general government debt should be calculated and reported in the government-wide governmental activities statements.

At year end, an accrual for interest payable must be recorded. This interest payable is equal to the amount of interest attributable to the period involved. The accrual is made in the proprietary fund or as an adjustment to the government-wide governmental activities statements, depending on what fund type the liability is related. Interest payable is not accrued in governmental funds **unless** cash has been transferred to a debt service fund for payment of principal or interest just after the end of the fiscal year. Because the cash would then be a current resource available in the debt service fund for payment of principal and interest immediately after the fiscal year end, it is appropriate to also accrue the payable against that cash. This prevents an overstatement of current resources available for expenditure in the next period. If this accrual is made in a governmental fund, no accrual is required in the government-wide reporting fund.

### ***Bond Financial Statement Reporting***

In the governmental fund financial statements, bond proceeds are reported as an other financing source. Expenditures related to bond issuance are reported as an other debt service expenditures. In the proprietary fund financial statements, bond proceeds and principal payments are never reported in the income statement/statement of changes in net assets.

For the government-wide financial statements, governmental funds are adjusted to reflect debt transactions for the reporting period. Governmental activities statements will not report proceeds and principal payments (after adjustments). For financial reporting purposes, the principal due within one year is reported separately from the long-term debt.

Governments must include required long-term debt disclosures in the notes to their financial statements. (Reference [Step 8: Securities Law Disclosure for Municipal Securities](#).) Relevant disclosures at year end include:

- A description of the types of long-term debt authorized to be issued.
- Schedules showing the changes in outstanding debt for each type of long-term debt for both governmental and business-type activities.

- Schedules of future debt service requirements (principal and interest displayed separately) for each type of long-term debt for both governmental and business-type activities.
- Terms and interest rates associated with variable-rate debt.
- Amounts of long-term debt due within one year of the date of the financial statements.
- Specific information related to demand bonds.

## DEBT REFUNDING & ADVANCE REFUNDING

### ***General Information***

Debt refundings involve the issuance of new debt (refunding bonds) whose proceeds are used to repay previously issued debt (refunded bonds). The refunding bond proceeds may be used to repay the refunded debt immediately (a Current Refunding), or may be placed with an Escrow Agent and invested until they are used to pay principal and interest on the refunded debt at a future time (an Advance Refunding). Most Advance Refundings result in defeasance of debt.

Defeasance of debt can be either legal or in-substance. A *legal defeasance* occurs when debt is legally satisfied based on certain provisions in the bond documents for the refunded debt even though the debt is not actually paid. An *in-substance defeasance* occurs when debt is considered defeased for accounting and financial reporting purposes even though a legal defeasance has not occurred. When debt is defeased, it is no longer reported as a liability in the accounting records; only the new debt is reported as a liability.

Debt is considered defeased in-substance for accounting and financial reporting purposes when:

- Assets are placed in irrevocable escrow to be used solely for the purpose of making payments of principal and interest on the refunded debt.
- The possibility that the Issuer or Obligor will be required to make future payments on that debt is remote.
- The assets in the escrow account are essentially risk-free as to amount, timing, and collection of interest and principal.
- The timing of collections approximately coincides with the timing and amount of scheduled principal and interest payments on the refunded debt.

### ***Accounting for Refunding of General Government Debt***

When accounting for a refunding of general government debt, the proceeds of the new debt and the payment of funds into escrow for the old debt are reported in the governmental fund. The debt itself is reported in the government-wide reporting fund. The amounts issued for Refunding (new) debt are reported as another financing source and those same amounts, when used to refund old debt, are reported as another financing use. Resources used from sources other than refunding debt are reported as debt service expenditures. In addition, premiums and discounts are

reported gross as either another financing source or other financing use, respectively. Issuance costs are reported as expenditures of the governmental fund.

Proceeds from refunding debt that are paid to the Escrow Agent and used to refund the old debt should be reported as an other financing use, even if the actual payment went directly from the counter party to the Escrow Agent. If the government uses funds from sources other than the refunding debt proceeds, such as a bond sinking fund, the payment should be charged to debt service expenditures rather than other financing uses.

The new debt liability is recorded in the government-wide reporting fund. The bonds in the government-wide reporting fund should be recorded at face value unless they are zero coupon or deep discount bonds.

In addition to recording the new debt, the government must remove the old debt from the accounting records. That includes any deferred charges, Underwriter's discounts, and discounts/premiums related to the old debt. The deferred gain or loss on the refunding must also be reported in the governmental activities statements. This is the difference between the reacquisition price and the net carrying amount.

Deferred charges, discounts/premiums, and Underwriter's discounts are amortized, as they would be for any other debt issue. The deferred loss/gain should be amortized over the shorter of the life of the new debt or the remaining life of the old debt. All balances should be amortized using a systematic and rational methodology.

#### ***Accounting for Refunding Debt in Proprietary Funds***

Refunding debt transactions are recorded in proprietary funds using the same methodology as governmental funds. Other financing sources and uses are not reported in the GAAP financial statements for proprietary funds.

#### ***Financial Statement Reporting of Refunded Debt***

A general description of debt refunding transactions must be included in the notes to the financial statements. In the year of the refunding, disclosures must include the difference between the cash flows required to service the old debt and the cash flows required to service the new debt. When measuring the difference between the two cash flows, additional cash used to complete the refunding (e.g., for issuance costs or payments to the Escrow Agent) paid from resources other than proceeds of the new debt should be added to the new debt cash flows. Accrued interest received at the bond issuance date should be excluded from the new debt cash flows. The economic gain or loss resulting from the transaction must also be disclosed. Economic gain or loss is the difference between the present value of the old debt service requirements and the present value of the new debt service requirements, discounted at the effective interest rate and adjusted for additional cash paid.

Although the liability for refunded bonds is no longer reported on the face of the financial statements, the amount of in-substance defeased debt must be disclosed in the notes to the financial statements until it is fully paid by the Escrow Agent. The amount of defeased debt is listed

separately to distinguish between governmental activities, business-type activities, and fiduciary fund activity.

## **ADDITIONAL ACCOUNTING & REPORTING RESOURCES**

Governments accounting and reporting for bond activity should ensure that staff has access to the following resources:

- [Governmental Accounting, Auditing, and Financial Reporting](#) (often referred to as "The Blue Book"), published by the Government Finance Officers Association.
- Governmental Accounting Standards Board (GASB) codification, original pronouncements, and implementation guides. Hard copy or electronic versions of these documents can be obtained from GASB at <http://gasb.org/>.
- The [State and Local Governments – Audit and Accounting Guide](#), published by the American Institute of Certified Public Accountants.

## **MAINTENANCE OF RATINGS DURING LIFE OF THE ISSUE**

For Issuers of bonds that are rated by one or more rating agencies, it is important that the Issuer keep each rating current by supplying information to the appropriate rating agencies on a regular or yearly basis to avoid a possible rating withdrawal. This, in turn, could reduce marketability for the Issuer's outstanding bonds.

A withdrawal due to inadequate information will negatively affect investors' opinions about management of the Issuer and will impair future desirability of the Issuer's bonds. It is a disservice to taxpayers and also to bondholders to allow the flow of information to rating agencies to deteriorate between bond sales.

Rating maintenance generally consists of forwarding annual reports and updated debt and economic information to the agencies. Rating maintenance may also require responding to rating agency questionnaires. It is especially important to make special contact whenever an unusual financial or economic event occurs which affects the Issuer.

## **NOTICE OF EARLY REDEMPTION**

The majority of bonds issued today are held in a book-entry only system (the Book Entry System), where the registered owner of all of the bonds will be The Depository Trust Company (DTC), New York, and the bonds will be registered in the name of Cede & Co., as nominee for DTC. The Issuer enters into a Blanket Issuer Letter of Representations (the Letter) wherein the Issuer represents that it will comply with the requirements stated in DTC's Operational Arrangements as they may be amended from time to time.

The Issuer and the Registrar may treat DTC (or its nominee) as the sole and exclusive registered owner of the bonds registered in its name for the purposes of:

- Payment of the principal, redemption price, premium (if any), and interest on the bonds;
- Selecting the bonds or portions thereof to be redeemed (if any);
- Giving notice as required under the authorizing resolution;
- Registering the transfer of bonds;
- Obtaining any consent or other action to be taken by the owners; and
- All other purposes needed.

## **ADVANCE REFUNDING AS A DEBT ADMINISTRATION TOOL**

An advance refunding is a procedure by which bonds are refunded early. Typically, this involves the sale of an issue prior to the first call date of the original issue. The Office of the State Treasurer (OST) is responsible for review and approval of proposed Advance Refundings. Prior to the Tax Cuts and Jobs Act eliminating tax-exempt Advance Refundings after January 1, 2018, Advance Refundings were usually executed to realize debt service savings when new bonds were sold at rates significantly below those of the original issue. As of January 1, 2018, Advance Refundings may be undertaken; to determine the structure most beneficial for your district's debt, it is recommended you consult a Municipal Advisor.

The Legislative Assembly declares that the issuance of Advance Refunding bonds and the authority to effect a Forward Current Refunding are matters of general statewide concern; a public body may issue Advance Refunding bonds or enter into Current Refundings in compliance with [ORS 287A.360-287A.380](#) and [Oregon Administrative Rule 170-062-0000](#) adopted by the OST.

### **Types of Advance Refundings**

#### *Net or Net Cash Defeasance*

The most common type of Advance Refunding is the net cash defeasance method. Bond proceeds are placed in an escrow account and are invested, usually in U.S. Treasuries, so that interest and principal of the investments **at their maturity** are sufficient to pay the principal, interest, and any call premiums on the refunded issue. Once proceeds of the Advance Refunding issue are invested and placed in the escrow and all legal requirements are met, the refunded issue is no longer considered outstanding (see [ORS 287A.195](#)). The refunded debt no longer counts toward any constitutional or statutory debt limit.

#### *Crossover Refunding*

On a Crossover Refunding, the proceeds of the Advance Refunding issue are invested in an escrow account so that the interest earnings and maturing principal are used to meet debt service requirements on this new obligation until the pre-arranged Crossover date.

The Crossover occurs on or after the first call date of the refunded issue. The Issuer continues to make debt service payments on the old issue until the Crossover takes place. *The original bonds are not defeased until they are actually retired and any covenants associated with the original debt remain in effect until the call.*

### **Federal Advance Refunding Regulations and State Treasurer's Office Review and Approval**

Advance Refunding issuance policy is governed by U.S. Treasury regulations relating to arbitrage bonds. The general purpose of the arbitrage rules, contained in Section 103 of the Internal Revenue Code, is to prevent municipalities from making a profit by selling tax-exempt bonds and investing the proceeds in higher-yielding taxable securities. Any bond, the proceeds of which are not invested in conformity with the specific yield restrictions of Section 103, is considered to be an Arbitrage Bond, unless certain exemptions are met.

The Office of the State Treasurer must review and approve all proposed Advance Refundings in Oregon in accordance with [ORS 287A.370](#) and [OAR 170-062-0000](#). The law mandates that the refunding plan be submitted to OST following adoption of the ordinance or resolution approving of the refunding plan.

Advance Refunding financings are often complex. OST requires that any Issuer considering an Advance Refunding consult with a Municipal Advisor early in the process regarding the process toward debt refinancing.