

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 municipality, at the time of or shortly after closing. The transcript includes all of 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, and the
- Escrow agreement.

While the paying agent typically provides an invoice to the issuer prior to a debt service payment date, it is the issuer's responsibility to ensure that 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 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 in the 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. If there is accrued interest earned and payable from date of issuance to date of sale of the debt, it is recorded in the fund that will be making the debt service payments. This interest is normally used to offset some portion of the first interest payment.

Often, the official bond documents require that the government establish reserves, which will be used for the payment of interest or principal on the debt 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 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. 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 whose proceeds are used to repay previously issued ("old") debt. The new debt proceeds may be used to repay the old debt immediately (a current refunding), or the new debt proceeds may be placed with an escrow agent and invested until they are used to pay principal and interest on the old 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 debt instrument 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 interest and principal on the old debt.
- The possibility that the debtor 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 interest and principal payments.

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 an "Other Financing Source" and those same amounts, when used to refund old debt, are reported as an "Other 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 an "Other 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 or bonds that are rated by a rating agency, 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 municipality'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 Treasurer is responsible for assessing the merit of proposed advance refunding issues and authorizing those having a significant beneficial impact. Advance refundings are usually executed to realize debt service savings when new bonds are sold at rates significantly below those of the original issue. An advance refunding may also be undertaken to reorganize permanent debt or to remove restrictive covenants.

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, and ORS 287A.360 to 287A.380 preempt all local statutory or charter authority to issue advance refunding bonds or to effect a forward current refunding.

A public body may issue advance refunding bonds or enter into current refundings in compliance with [ORS 287A.360-287A.380](#) and rules adopted by the Office of the State Treasurer.

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 municipality 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.*

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.

The Office of the State Treasurer must review and approve all proposed advance refundings in Oregon in accordance with [ORS 287A.370](#) and [OAR 170-062-000](#). The law mandates that the refunding plan be submitted to the State Treasurer following adoption of the ordinance or resolution approving of the refunding plan.

Rule G-36 of the Municipal Securities Rulemaking Board ([MSRB](#)) requires that the underwriter send to the MSRB the refunding escrow trust agreement or equivalent, together with completed Forms G-36 (ARD) within five business days after delivery of the securities by the issuer to the underwriters.

Advance refunding financings are often complex. The MDAC recommends that any issuer considering an advance refunding consult with a municipal advisor early in the process regarding the process toward debt refinancing.