

FINANCIAL MANAGEMENT FOR GEORGIA LOCAL UNITS OF ADMINISTRATION

Date Issued	Effective Date	Section	Title:
07/01/94	07/01/94	I	GAAP Accounting and Financial Reporting Principles
Revision No.	Date Revised	Chapter	Title:
4	March 2017	I-16	Debt Service Funds

INTRODUCTION

Georgia Local Units of Administration (LUAs) use debt service funds to account for the accumulation of resources for, and the payment of, general long-term debt principal and interest. The Governmental Accounting Standards Board's 2015-2016 Codification of Governmental Accounting and Financial Reporting Standards (2015-2016 Codification), Section 1300.107, states, "Debt service funds should be used to report resources if legally mandated. Financial resources that are being accumulated for principal and interest maturing in future years also should be reported in debt service funds." In Georgia, LUAs are required to use debt service funds to account for the retirement of general obligation bonds and to record the interest costs associated with these bonds.

NUMBER OF FUNDS

LUAs should establish separate debt service funds for each bond issue. However, if the LUA levies a single amount of property tax for repayment of several general obligation bonds, they may use a single debt service fund to retire all these bonds. This use is appropriate since property tax revenues are not distinguishable by separate bond issue. LUAs are required to maintain a separate debt service fund to repay general obligation debt retired from Special Purpose Local Option Sales Taxes (SPLOST).

SPECIAL PURPOSE LOCAL OPTION SALES TAXES

All SPLOST revenue shall be deposited in accordance with the SPLOST referendum and/or bond covenants. If the LUA sells revenue bonds guaranteed by SPLOST revenues, the LUAs must use these revenues to retire the revenue debt. In these instances, the LUA shall transfer the SPLOST from the capital projects fund to the debt service fund in accordance with the bond covenants. If approved in the referendum, LUAs may use SPLOST to retire existing general obligation debt (i.e., debt issued before the SPLOST referendum). In these

instances, the LUA should record the SPLOST initially in a capital projects fund and then transfer the proceeds to a debt service fund.

Per Article VIII, Section VI, Paragraph IV of the Georgia Constitution, if a SPLOST tax is imposed to pay off specific general obligation bond debt, the property tax revenue previously levied to pay for the said debt shall be reduced based on the amount of SPLOST proceeds that will be used. A district cannot continue levying the bond millage for debt that will no longer be paid with that revenue base because of SPLOST.

However, a district can still issue a bond millage to collect property tax revenue to pay off general obligation debt that is not being repaid from SPLOST revenues. There are occasions in which a district will issue SPLOST with the intent to pay off general obligation debt but the SPLOST proceeds decrease and are not sufficient to pay the debt. In those cases, bond millages can be levied to pay off debt, as long as the SPLOST funds are not being earned for the same purpose.

In addition, SPLOST revenues, authorized for capital outlay projects for educational purposes, shall not be used to repay bonds issued with the intent of being repaid with debt service property tax revenues unless:

- The school board's resolution authorizing the SPLOST specifically included, as one of its purposes, repayment of previously incurred general obligation debt with respect to capital outlay projects of the school system.
- The school board authorizes, through proper resolution, that the LUA may use any residual balance remaining in any debt service fund, after all bond principal and interest associated with that specific debt service fund have been retired, to retire any outstanding general obligation bond debt.

ACCOUNTING ISSUES

At the fund reporting level, LUAs account for debt service funds on the modified accrual basis of accounting using the current financial resources measurement focus. Chapter I - 7 explains these concepts. Several accounting issues are associated with debt service funds. These issues include expenditure recognition and advance debt refundings.

Expenditure Recognition

One exception to recording expenditure accruals at the fund reporting level relates to unmatured principal and interest associated with long-term general obligation debt. LUAs must record debt service principal and interest expenditures when the payments are due. The "when due" exception to expenditure recognition was established to "match" debt service expenditures with resources accumulated to repay the debt. This approach prevents an understatement or overstatement of debt service fund's fund balance.

As an option, when resources are provided to the debt service fund before year end, for debt service payments due early in the next year, the LUA may recognize an expenditure, in the current year for this debt service principal and interest (i.e., before it is due). The phrase “due early in the next year” is limited to one month, or the month of July following year-end. GAAP permits this treatment to avoid an overstatement of fund balance in the debt service fund at June 30.

Advance Debt Refundings

In addition to normal repayment, debt may be extinguished through an advance refunding. An advance refunding takes place when monies are provided (at least in part by a new debt issuance) to retire previously issued debt as it matures or at the call date. The 2015-2016 Codification D20.105 – D20.106 provides that debt may be considered extinguished, and both debt and related assets may be removed from the balance sheet, when an advance refunding results in a legal or an in-substance defeasance. According to 2015-2016 Codification D20.105, an advance refunding results in a legal defeasance when “debt is legally satisfied based on certain provisions in the debt instrument even though the debt is not actually paid.” A legal defeasance is rare in the LUA environment and generally would occur only when an amount sufficient to pay both principal and interest at the time of deposit is placed in an irrevocable trust with an independent escrow agent.

The 2015-2016 Codification D20.106 also specifies criteria for an in-substance defeasance. An in-substance defeasance occurs when the “debtor irrevocably places cash or other assets with an escrow agent in a trust to be used solely for satisfying scheduled payments of both interest and principal of the defeased debt, and the possibility that the debtor will be required to make future payments on that debt is remote.”

For an asset to qualify as essentially risk free, it should be either a direct obligation of the U.S. Government, an obligation guaranteed by U.S. Government, or securities backed by U.S. Government obligations.

Fund Reporting Level

At the fund reporting level, when a LUA reports an advance refunding that results in the defeasance of debt, the 2015-2016 Codification, Section D20.109, provides specific guidance. The face amount of the refunding debt (i.e., new debt) should be reported as an "other financing source – proceeds of refunding bonds" in the fund receiving the proceeds.

The classification of payments to the escrow agent is dependent on the resources used. LUAs should classify payments to the escrow agent from resources provided by the refunding issue as an "other financing use – payment to refunded bond escrow agent." Payments to the escrow agent from other resources (e.g., transfers, debt service property taxes) should be reported as debt service expenditures.

Government-wide Reporting Level

As indicated above, there often is a difference between the carrying amount of redeemed/defeased debt and its reacquisition price. The 2015-2016 Codification D20.111 indicates this difference should be reported as a deferred outflow of resources or deferred inflow of resources and recognized as a component of interest expense. At the government wide reporting level, LUAs defer and amortize this amount over the shorter of:

- 1) The original amortization period remaining from the prior refundings, or
- 2) The life of the latest refunding debt.

In the meantime, the unamortized difference between the carrying amount of redeemed or defeased debt and its reacquisition price should be reported as a direct reduction of (or addition to) the amount of refunding debt reported on the statement of position, much like a bond premium or discount.

ILLUSTRATIVE JOURNAL ENTRIES AT THE FUND REPORTING LEVEL

The following discussion and journal entries illustrate the more common debt service fund transactions under the modified accrual basis of accounting.

Transaction - an LUA levies \$1,595,000 of property taxes during the current year to provide resources for debt service expenditures. Payment of the taxes is due before year-end.

<u>Description</u>	<u>Account No.</u>	<u>DR</u>	<u>CR</u>
Taxes receivable	0121	\$1,595,000	
Deferred Inflow-Unavailable Revenue	0481		\$1,595,000

Explanation - There are two options for a LUA to use to record property taxes. In this option, the LUA does not recognize any of the taxes they levied as revenue since they are not estimating the amount that will become available (i.e., they are assuming that none of the receivable is available at this time, therefore, they do not recognize any revenue.

Transaction - the LUA collects \$1,585,000 of the current year's tax levy before year-end.

<u>Description</u>	<u>Account No.</u>	<u>DR</u>	<u>CR</u>
Cash in bank	0101	\$1,585,000	
Taxes receivable	0121		\$1,585,000

<u>Description</u>	<u>Account No.</u>	<u>DR</u>	<u>CR</u>
Deferred inflow of resources	0481	\$1,585,000	
Ad Valorem Taxes	1110		\$1,585,000

Explanation: Since the LUA did not recognize revenue in the first transaction, each time taxes are collected, it removes a like amount from unavailable revenue (deferred inflow of resources) and recognizes it as revenue since the collected taxes are now available.

Transaction (the second option) - In the same property tax transaction as above, the LUA estimates that \$1,590,000 will be available sometime during the current fiscal year.

<u>Description</u>	<u>Account No.</u>	<u>DR</u>	<u>CR</u>
Taxes receivable	0121	\$1,595,000	
Ad valorem taxes	1110		\$1,590,000
Deferred inflow of resources/ unavailable revenue	0481		\$5,000

Explanation: With this option, the LUA assumes that it will receive \$1,590,000 in the available period and it records the revenue in a like amount. It reports the balance as deferred inflow of resources.

Transaction - the LUA collects \$1,585,000 of the current year's tax levy before year-end.

<u>Description</u>	<u>Account No.</u>	<u>DR</u>	<u>CR</u>
Cash in bank	0101	\$1,585,000	
Taxes receivable	0121		\$1,585,000

Explanation: Since the LUA has recognized all the above collection as revenue, the collection of the receivable is the only required recording.

Transaction - previously purchased investments mature and proceeds of \$1,557,000 that includes \$62,000 of interest, is received.

<u>Description</u>	<u>Account No.</u>	<u>DR</u>	<u>CR</u>
Cash in bank	0101	\$1,557,000	
Investments	0111		\$1,495,000
Investment Income	1500		\$62,000

Explanation: The cost of the investment is credited and the interest is recorded as revenue.

Transaction - QZAB Bonds were sold and the annual payments on the debt are actually payments to an investment account in the school district's name. The investment is held until the bond debt matures.

<u>Description</u>	<u>Account No.</u>	<u>DR</u>	<u>CR</u>
Investments	0111	\$2,000,000	
Cash	0101		\$2,000,000

Explanation: The QZAB payment is transferred to an investment account and held in the school district's name.

Transaction - the LUA invests \$1,500,000 of the property tax revenues.

<u>Description</u>	<u>Account No.</u>	<u>DR</u>	<u>CR</u>
Investments	0111	\$1,500,000	
Cash in bank	0101		\$1,500,000

Explanation: This transaction is a simple balance sheet transaction.

Transaction - the LUA determines during the year that a \$4,000,000 advance refunding of general obligation bonds (refunded bonds) can be achieved with a \$4,315,000 payment into an escrow account. Resources for the advance refunding are obtained through the sale of \$4,365,000 in general obligation bonds (refunding bonds) and the use of \$15,000 in debt service funds resources. Issuance costs associated with the refunding bonds amount to \$65,000 and there are no bond premiums or discounts.

<u>Description</u>	<u>Account No.</u>	<u>DR</u>	<u>CR</u>
Cash in bank	0101	\$4,300,000	
Dues and fees	5100-810	\$65,000	
Other financing sources			
- Sale of bonds	5100		\$4,365,000

Explanation: The LUA reports the bonds at their face value and reports the bond issuance costs as an expenditure.

Transaction - the LUA remits \$4,315,000 to the refunded bond escrow agent from refunding bond proceeds (\$4,300,000) and debt service fund resources (\$15,000).

<u>Description</u>	<u>Account No.</u>	<u>DR</u>	<u>CR</u>
Dues and fees	5100-810	\$15,000	
Other Financing Use – Payment to Bond Escrow Agent	5100-831	\$4,300,000	
Cash in bank	0101		\$4,315,000

Explanation - On the operating statement, the principal portion would be reported as an other financing use and the \$15,000 is reported as an expenditure.

Transaction - the LUA remits to its fiscal agent annual bond principal payments of \$2,030,000 and semiannual interest payments of \$1,478,000. Of the \$3,508,000 remitted, \$3,500,000 (\$2,025,000 principal and \$1,475,000 interest) was paid to bondholders by the fiscal agent.

<u>Description</u>	<u>Account No.</u>	<u>DR</u>	<u>CR</u>
Redemption of bond principal	5100-831	\$2,030,000	
Interest	5100-830	\$1,478,000	
Cash in bank	0101		\$3,508,000

Explanation: Since the fiscal agent redeems this bond principal and interest immediately upon receipt, the LUA treats the transaction as an expenditure. If the fiscal agent was not retiring the debt immediately, the LUA would record this payment as “cash with fiscal agent.” Then ultimately, when the fiscal agent paid the principal and interest, the LUA would report the expenditure and reduce the cash with fiscal agent account.

Transaction - at year-end, \$30,000 of interest revenue is accrued on outstanding investments.

<u>Description</u>	<u>Account No.</u>	<u>DR</u>	<u>CR</u>
Interest receivable	0114	\$30,000	
Investment Income	1500		\$30,000

Explanation: The LUA may accrue the interest at the fund reporting level if considered available.

SUMMARY

1. Georgia Local Units of Administration (LUAs) use debt service funds to account for the accumulation of resources for, and the payment of, general long-term debt principal and interest.
2. LUAs should establish separate debt service funds for each bond issue. However, if the LUA levies a single amount of property tax for repayment of several general obligation bonds, they may use a single debt service fund to retire all these bonds.
3. All SPLOST revenue shall be reported in either the capital projects fund or the debt service fund as indicated by the SPLOST referendum and/or bond covenants.
4. At the fund reporting level, LUAs account for debt service funds on the modified accrual basis of accounting using the current financial resources measurement focus.
5. LUAs must record debt service principal and interest expenditures when the payments are due. The "when due" exception to expenditure recognition was established to "match" debt service expenditures with resources accumulated to repay the debt.
6. An advance refunding takes place when monies are provided (at least in part by a new debt issuance) to retire previously issued debt as it matures or at the call date.
7. At the fund reporting level, when a LUA reports an advance refunding that results in the defeasance of debt, the face amount of the refunding debt (i.e., new debt) should be reported as an "other financing source – proceeds of refunding bonds" in the fund receiving the proceeds.
8. Payments to the escrow agent from other resources (e.g., transfers, debt service property taxes) should be reported as debt service expenditures.