

Debt Refunding – Some Things To Consider, Continued

Accounting & Financial Statement Disclosure Considerations



By
Andrew Laflin, CPA



Calculation of Deferred Amount on Refunding

- **Reacquisition Price of the Old Debt** (Principal amount remaining on the old debt plus any call premium or any miscellaneous reacquisition costs that must be paid to refund the debt currently) (Accrued interest should not be included in the reacquisition price for a current refunding, but should be recorded as interest expense, as discussed in the *GASB Comprehensive Implementation Guide—2011-2012*, Question Z.23.1.)
 - Less:
- **Net Carrying Amount of the Old Debt** (Amount due at maturity for the old debt plus or minus any unamortized debt premium/discount and debt issue costs related to the old debt.) [GASBS No. 23]

Reporting of Deferred Amount on Refunding

- The deferred amount should be reported in the proprietary fund and government wide statement of net assets as a deduction from or an addition to the new debt liability
- Premiums/discounts and debt issue costs pertaining to the new debt issue should be deferred and amortized separately

Amortization of Deferred Amount on Refunding

- GASBS No. 23, paragraph 5, requires the deferred amount to be amortized as an element of interest expense in a systematic and rational manner over the shorter of the original amortization period remaining from the prior refundings or the life of the latest refunding debt (the new debt).

Amortization of Discount or Premium

- APBO No. 21, *Interest on Receivables and Payables*, and GASBS No. 62, paragraph 185, require a debt issuance discount or premium to be amortized as interest expense or interest income over the life of the debt using the “interest” method.

Accounting for Deferred Charges

- APBO No. 12 and GASBS No. 62, paragraph 187, also require proprietary and fiduciary funds to defer debt issue costs and amortize those costs as a component of interest expense over the life of the debt. These costs should be reported separately as deferred charges.
- The bond issuance costs should be amortized as an element of interest expense in a systematic and rational manner over the shorter of the original amortization period remaining from the prior refundings or the life of the latest refunding debt (the new debt).

Disclosure Requirements

- GASB Statement No. 7, para 11, requires that the financial statements provide a general description of all current and advance refundings that occurred during the year—regardless of the fund type used to report the transaction in the fund financial statements. The disclosures should also include the following for each refunding:
 - The difference between the cash flows required to service the old debt and the new debt, including cash obtained from resources other than the proceeds of the new debt.
 - The economic gain or loss resulting from the refunding transaction, calculated on a present value basis.

Example Disclosure – Advance Refunding

On April 1, 2013, the City issued \$36.3 million in gas tax special revenue refunding bonds with interest rates ranging between 2.75% and 5.25%. The City issued the bonds to advance refund \$31.6 million of the outstanding series 2006 special revenue bonds with a 7.2% interest rate. The City used the net proceeds along with other resources to purchase U.S. government securities. These securities were deposited in an irrevocable trust to provide for all future debt service on the refunded portion of the 2006 series bonds. As a result, that portion of the 2006 series bonds is considered defeased, and the City has removed the liability from its accounts. The outstanding principal of the defeased bonds is \$31,565,000 at September 30, 2013. The advance refunding reduced total debt service payments over the next 23 years by nearly \$4.5 million. This results in an economic gain (difference between the present values of the debt service payments on the old and new debt) of \$2.5 million.

Sample Problem

- Water & Sewer Fund issues \$10,410,000 (5 yr. \$10m 9% bond issued in an 8% market) of Utility System Refunding Bonds to refund (current) the Utility System Revenue Bonds, Series 1996.
- The remaining principal balance on the revenue bonds was \$8,800,000, along with accrued interest of \$325,000. The proceeds were also used to pay \$150,000 of issuance costs incurred on the refunding bonds, as well as a fee of \$45,000 in order to retire the revenue bonds before their actual maturity date.
- The \$8.8m revenue bonds had a remaining unamortized discount of \$221,000 plus remaining unamortized bond issue costs of \$67,000.

Solution – Journal Entries

- Cash \$10,410,000
- Utility Refunding Bonds \$10,000,000
- Premium on Bonds Payable \$410,000

- Utility Revenue Bonds \$8,800,000
- Cash \$8,800,000

- Accrued Interest Payable \$325,000
- Cash \$325,000

Solution – Journal Entries, cont.

- Deferred Amount on Refunding \$45,000
- Cash \$45,000

- Bond Issuance Costs – Refunding Bonds \$150,000
- Cash \$150,000

- Deferred Amount on Refunding \$221,000
- Bond Discount – Utility Revenue Bonds \$221,000

- Deferred Amount on Refunding \$67,000
- Bond Issuance Costs – Utility Revenue Bonds \$67,000

Solution – Deferred Amount on Refunding

- Net deferred amount on refunding to be amortized: \$333,000 (\$45k + \$221k + \$67k)
- Assume original debt matured in 7 years:

Period	Beginning Balance	Amortization Expense	Ending Balance
10/1/2012			\$ 333,000
10/1/2013	333,000	66,600	266,400
10/1/2014	266,400	66,600	199,800
10/1/2015	199,800	66,600	133,200
10/1/2016	133,200	66,600	66,600
10/1/2017	66,600	66,600	-

- Assume original debt matured in 3 years:

Period	Beginning Balance	Amortization Expense	Ending Balance
10/1/2012			\$ 333,000
10/1/2013	333,000	111,000	222,000
10/1/2014	222,000	111,000	111,000
10/1/2015	111,000	111,000	-

What If This Was an Advance Refunding?

- In a current refunding, per GASB Comprehensive Implementation Guide—2012-2013, Question Z.23.1, payments made from new debt proceeds that represent payment of accrued interest on the refunded debt should be reported as interest expense
- The same calculation is required for determining the deferred amount in an advance refunding except that the reacquisition price of the old debt is the amount of money required to be placed in escrow.

Questions and Comments

Andrew Laflin, CPA

Manager

CliftonLarsonAllen LLP

(813) 384-2711 (office)

(813) 784-3140 (cell)

andrew.laflin@cliftonlarsonallen.com