FINANCIAL MANAGEMENT FOR GEORGIA LOCAL UNITS OF ADMINISTRATION

Date Issued	Effective Date	Section	Title:
July 1, 1994	July 1, 1994	I	GAAP Accounting and Financial Reporting Principles
Revision No.	**Date Revised**	**Chapter**	**Title:**
1	August 2008	17	Long-Term Debt

NATURE AND PURPOSE

Long-term liabilities include unmatured principal on debt, capital lease obligations, compensated absences, and claims and judgments. The 2009 *Codification*, Section 1500 states long-term liabilities should be categorized into fund long-term liabilities and general long-term liabilities. Long-term liabilities related directly to either proprietary or fiduciary funds should be reported in both the fund financial statements and the government-wide financial statements. Long-term liabilities related to governmental funds should be reported only in the government-wide statement of net assets. Long-term obligations do not require the use of current financial resources and, therefore, should NOT be reported in the fund financial statements

Matured liabilities of governmental funds should be included as fund liabilities (GASB Interpretation 6). Any liability expected to be liquidated with available, spendable resources should be included as a fund liability.

Proceeds from bonds issued for governmental funds should be recorded on the fund operating statement as “Other Financing Sources-Bond Proceeds”. General long-term debt (Entity Wide – Governmental Funds) should be used to account for a Local Unit of Administration's (LUA) unmatured long-term indebtedness that has not been identified as a specific fund liability of a proprietary or trust fund. Besides general obligation debt instruments (e.g., bonds, notes), certain liabilities that normally are not expected to be liquidated with expendable available financial resources (e.g., compensated absences, claims, and judgments) are reported here, and, in the fiscal year end financial statements, on the entity-wide Statement of Net Assets

ACCOUNTING ISSUES

Several accounting issues associated with long term debt have been identified. These issues are described below.

Bond Anticipation Notes

Notes of various maturities issued in anticipation of future bond sales commonly are referred to as bond anticipation notes (BANs). BANs generally are issued because an LUA either is waiting for more favorable interest rates or has additional projects that also require financing which would warrant a bond issue. Accounting for BANs is addressed in the 2009 *Codification*, Section B50.102:

> For governmental funds, if all legal steps have been taken to refinance the bond anticipation notes and the intent is supported by an ability to consummate refinancing the short-term notes on a long-term basis in accordance with the criteria set forth in FASB Statement No. 6 [SFAS No. 6], *Classification of Short-Term Obligations Expected to Be Refinanced*, they should be reported as general long term liabilities in the government activities column of the government-wide statement of net assets. If the necessary legal steps and the ability to consummate refinancing criteria have not been met, then the bond anticipation notes should be reported as a fund liability in the governmental fund receiving proceeds as well as in the government-wide statement of net assets.

As outlined in SFAS NO. 6, the "ability to consummate the refinancing" can be demonstrated in one of two ways. On the one hand, BANs should be reported in the government-wide financial statements if, during the period between the balance sheet date and the issuance of the financial report, the government does, in fact, issue obligations that meet the criterion of Accounting Research Bulletin No. 43, *Restatement and Revision of Accounting Research Bulletins*, for classification as long-term liabilities (i.e., mature more than 12 months following the balance sheet date). Therefore, if BANs are to be replaced by other BANs that mature more than 12 months after the balance sheet date, the BANs should be reported in the government-wide financial statements.

SFAS NO. 6 also provides that obligations can be classified as long-term if a financing agreement exists that allows the government to refinance the BANs on a long-term basis even if such a refinancing has not occurred by the time the financial statements are issued.

Tax and Revenue Anticipation Notes

Tax and revenue anticipation notes are debt instruments governments use to borrow in anticipation of property taxes or other revenue sources. Governments report tax and revenue anticipation notes as a fund liability in the governmental fund receiving the proceeds pursuant to 2009 *Codification* Section B50.

Demand Bonds

Issues similar to those encountered with BANs are faced with demand bonds as well. Authoritative literature defines demand bonds as debt instruments that contain demand (i.e., "put") provisions that are exercisable within a one-year period beginning at the balance sheet date. Specific classification guidance is set forth in the 2009 *Codification*, Section D30.108. It provides that bonds should be reported by governments as general long-term liabilities (shown on the government-wide financial statements only) or excluded from current liabilities of proprietary funds if all of the following conditions are met.

- Before the financial statements are issued, the issuer has entered into an arm's-length financing (take out) agreement to convert bonds "put" but not resold into some other form of long-term obligation.

- The take out agreement does not expire within one year from the date of the issuer's balance sheet.

- The take out agreement is not cancelable by the lender or the prospective lender during that year, and obligations incurred under the take out agreement are not callable by the lender during that year.

- The lender or the prospective lender or investor is expected to be financially capable of honoring the take out agreement.

Demand bonds should be reported as fund liabilities or as current liabilities when the preceding conditions are not met.

Arbitrage Rebate Liability

Arbitrage in government finance generally is defined as the process of investing low-yielding, tax-exempt bond proceeds in higher-yielding, taxable securities, which results in interest revenue exceeding interest cost. The Tax Reform Act of 1986 requires that these arbitrage interest earnings be remitted to the federal government.

Based upon the U.S. Treasury Department regulations, a government must rebate excess earnings once every five years or upon maturity of the bonds, whichever is earlier. Nevertheless, it appears that annual calculations of rebatable amounts may be necessary every year to meet GAAP. LUAs should use SFAS 5, *Accounting for Contingencies* whether to record the arbitrage rebate liability. The liability for arbitrage rebate is always reported in the government-wide statement of net assets and as a fund liability when the amounts become due and payable. Generally, exceptions to the arbitrage rebate requirements follow:

1. If the bond issue amount is less than $10,000,000 in total for school construction
2. Spending exceptions
   a. 6 month spending exception – If the gross proceeds will be spent in six months, not including amounts deposited into a Reserve Fund.
   b. 18 month spending exception – If 15% of the gross proceeds are spent in the first 6 months, 60% of the gross proceeds are spent within the first 12 months, and 100% of the gross proceeds are spent in 18 months, not including amounts deposited into a Reserve Fund.
   c. 24 month spending exception – If 10% of the gross proceeds are spent within 6 months, 45% in 12 months, 75% in 18 months, and 100% in 24 months

The complex exceptions may be found at 26CFR 1.148-7. The penalties for failure to remit required rebate amounts to the IRS could mean a loss of tax-exempt status for the issue. Services of a competent professional should be sought to assist with complying with these requirements.

ILLUSTRATIVE JOURNAL ENTRIES

Chapter 15, Debt Service Funds, discusses entries for bond issuance and refunding.

The following discussion and journal entries illustrate issuance, accrual and retirement of general long-term liabilities reported in the Entity-Wide Governmental funds.

Transaction - the LUA enters into capital leases for the acquisition of computer equipment. The net present value of future minimum lease payments is $140,000.

Description	Account No.	DR	CR
Amount to be provided from general government resources	0304	$140,000	
Capital leases payable	0531		$140,000

Explanation - The other debit account, "amount to be provided" is increased and the "capital leases payable" is increased.

Transaction - during the year, the LUA incurs $854,000 of additional liability for compensated absences. The liability is not expected to be liquidated with "expendable available financial resources."

Description	Account No.	DR	CR
Amount to be provided from general government resources	0304	$854,000	
Compensated absences payable	0551		$854,000

Explanation - If an amount had been reported in prior years, a journal entry for the difference to increase the liability to the total liability would be made. Normally this entry is made at year-end only.

Transaction - the LUA issues $3,365,000 of refunding bonds to defease $3,000,000 of outstanding bonds.

Description	Account No.	DR	CR
General obligation bonds payable	0511	$3,000,000	
Amount to be provided from general government resources	0304		$3,000,000

Description	Account No.	DR	CR
Amount to be provided from general government resources	0304	$3,365,000	
General obligation bonds payable	0511		$3,365,000

Explanation - The first entry removes the refunded debt (i.e., the old debt) from the Entity-Wide – Governmental Funds and the second entry records the liability for the refunding debt (i.e., the new debt).

Transaction - the LUA remits annual bond principal payments of $2,030,000 to fiscal agent.

Description	Account No.	DR	CR
General obligation bonds payable	0511	$2,030,000	
Amount to be provided from general government resources	0304		$2,030,000

Transaction - as part of the capital lease arrangements, a payment of $15,000 is made.

Description	Account No.	DR	CR
Capital leases payable	0531	$15,000	
Amount to be provided from general government resources	0304		$15,000

Transaction - during the year, the amount available in the debt service fund for the payment of bond principal increased by $1,374,000.

Description	Account No.	DR	CR
Amount available in the debt service fund for the retirement of general obligation bonds	0303	$1,374,000	
Amount to be provided from general government resources	0304		$1,374,000

Explanation - This entry would be made at year-end to adjust the "amount available for retirement of general long-term debt based upon the amount of fund balance in the debt service fund."

See Chapter 22G for information regarding adjustments related to bond premiums, discounts, and issuance costs necessary for the preparation of the government-wide financial statements.