



# Accounting and Financial Reporting for Debt

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Focused  
on YOU



# LOOK AT GASBs EFFECTING DEBT REPORTING



## Effective Now

- GASB 86 – Certain Debt Extinguishment Issues

## Effective 18/19

- GASB 88 – Certain Debt Disclosures Related to Debt, including Direct Borrowings and Direct Placements

## Effective 20/21

- Accounting for Interest Cost Incurred before the End of a Construction Period

## Effective 21/22

- PROPOSED GASB – Conduit Debt Obligations

## **GASB 86**

### **Certain Debt Extinguishment Issues**

- Exiting resources (cash on hand, not proceeds from refunding debt) are placed in an irrevocable trust for the sole purpose of extinguishing debt.
- Change to accounting for prepaid insurance on debt that is extinguished
- Notes to financial statements for debt that is defeased in substance



## GASB 86 Certain Debt Extinguishment Issues

- **In-Substance Defeasance of Debt Using Only Existing Resources**
  - This statement essentially follows the same requirements of Statement 7, Advance Refunding Resulting in Defeasance of Debt.
  - But the financial statements would recognize any difference between the reacquisition price (amount put into the trust) and the net carrying amount of the debt defeased in substance (gain/loss) immediately.
  - Disclose the transaction in the period of defeasance.
  - Disclose the outstanding balance of the defeased debt each year after.



debt



## **Revisit In-substance defeasance**

- Money placed in an irrevocable trust with escrow agent
- Trust is solely for satisfying scheduled payments of both interest and principal of defeased debt
- The possibility that the government will be required to make future payments on the debt is remote
- Trust is restricted to owning only risk-free monetary assets
- Monetary asset currency denomination is same as debt payable



## **U.S. Dollar, essentially risk-free monetary assets :**

- Direct obligations of the U.S. Government
- Obligations guaranteed by the U.S. Government
- Securities backed by U.S. Government obligations
- **NOTE:** *If escrow securities are callable, there is no assurance that the reinvested funds would provide the yields to meet the required debt service payments. This would not qualify for defeasance purposes.*





## **Financial reporting of defeasance**

- Full Accrual Presentation
  - Liability would be removed
  - Deferred inflow/outflow would be removed
  - Cash would be reduced
  - Gain/Loss is recognized
- Modified Accrual Presentation
  - Reduce Cash
  - Record debt service expenditure
- Footnote Disclosure
  - Description of transaction
    - Amount of the debt paid
    - Amount of money sent to escrow agent
    - Reason for defeasance
    - Cashflow required to service the defeased debt
  - Future periods
    - Remaining outstanding balance of defeased debt



## GASB 86 Certain Debt Extinguishment Issues

- **Prepaid Insurance Related to Extinguished Debt**
  - This should be included in the net carrying amount of that debt when calculating the gain/loss on in-substance defeasance or extinguishment



## GASB 86 Certain Debt Extinguishment Issues

- **Additional Disclosure for All In-Substance Defeasance Transactions**
  - In-substance defeasance usually contains essentially risk-free monetary assets in the trust.
  - If monetary assets held in the trust are NOT essentially risk-free, additional disclosure of this fact is required
    - In subsequent periods, also disclose the outstanding balance of in-substance defeasance related to the risk.





## GASB 88

### Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements

- Clarifies which liabilities governments should include when disclosing debt information
- Defines debt and disclosures resulting from a contractual obligation with a set fixed amount and date
- Other disclosure requirements related to debt
  - Unused credit lines
  - Assets pledged as collateral for debt
  - Terms related to significant events of default
  - Significant termination events
  - Significant subjective acceleration clauses

2018 – 2019

## Clarifies which liabilities governments should include when disclosing debt information

- Direct Borrowings
  - Loan Agreements with lenders
- Direct Placements
  - Debt Security directly to an investor
- Direct Borrowings and Direct Placements
  - Negotiated directly with the investor or lender
  - Not offered for public sale



Defines debt and disclosures resulting from a contractual obligation with a set fixed amount and date

- Fixed Amount
  - Variable Rate Interest
  - Capital Appreciation Bonds
- Do not preclude the amount to be settled from being considered fixed



## Other disclosure requirements related to debt

- Amounts of unused lines of credit
- Assets pledged as collateral for debt
- Terms specified in debt agreements related to significant
  - Events of default
  - Termination events
  - Subjective acceleration clauses
- Separate direct borrows and direct placements from other debt





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## GASB 88 Statement Example – Appendix C

- **Governmental Activities:**
  - General obligation bonds, \$12,530, 000
  - Notes from direct borrowing and direct placements, \$941,918
- **Business-type Activities:**
  - Notes from direct borrowing, \$70,400
  - Pledged undeveloped lot for commercial use
  - Termination event changes timing of repayment to immediate if pledged revenues in the year are less than 120% of debt service due the following year
  - Acceleration clause; allowing the lender to accelerate payment of the entire principal amount if lender determines that a material adverse change occurs.
- All notes contain an event of default = immediately due
- Outstanding line of credit of \$1,500,000



## Disclosure Example

- Changes in long-term obligations for the year ended June 30, 20xx, are as follows:

	<u>Balance at July 1, 20xx</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at June 30, 20xx</u>	<u>Due within One Year</u>
<b><u>Governmental activities:</u></b>					
General obligation bonds	\$ 21,500,000	\$ -	\$ 8,970,000	\$ 12,530,000	\$ 7,050,000
Notes from direct borrowings and direct placements	1,412,877	-	470,959	941,918	470,959
Total	<u>\$ 22,912,877</u>	<u>\$ -</u>	<u>\$ 9,440,959</u>	<u>\$ 13,471,918</u>	<u>\$ 7,520,959</u>
<b><u>Business-type activities:</u></b>					
Notes from direct borrowings	<u>\$ 76,800</u>	<u>\$ -</u>	<u>\$ 6,400</u>	<u>\$ 70,400</u>	<u>\$ 6,400</u>

- ✓ Note that these debts are separate from other debts
- ✓ They do not have to be grouped together as shown here

## Disclosure Example

- The Government's outstanding notes from direct borrowings and direct placements related to government activities of \$941,918 contain a provision that in an event of default, outstanding amounts become immediately due if the Government is unable to make payment.

## Disclosure Example

- The Government's outstanding notes from direct borrowings relate to business-type activities of \$70,400 are secured with collateral of an undeveloped lot zoned for commercial use. In addition they contain (1) a provision that in an event of default, the timing of repayment of outstanding amounts become immediately due if pledged revenues during the year are less than 120% of debt service coverage due in the following year and (2) a provision if that Government is unable to make payment, outstanding amounts are due immediately. As well as an acceleration clause that allows the lender to accelerate payment of the entire principal amount outstanding if the lender determines that a material adverse change occurs.

## Disclosure Example

- The Government also has an unused line of credit in the amount of \$1,500,000.

Debt service requirements on long-term debt at June 30, 20xx, are as follows:

Show debt services schedules here as usual

## **GASB 89**

### **Accounting for Interest Cost Incurred before the End of a Construction Period**

- Changes accounting requirements for interest cost incurred before the end of a construction period.
- Including such interest cost that previously was accounted for in accordance with GASB 62.
- Resulting in interest cost incurred before the end of a construction period to be recognized as an expense and NOT to be included in the historical cost of a capital asset.



## Accounting for interest cost

- This is a prospective application.
- Earlier application is encouraged.
- CIP, interest cost incurred in the fiscal year of implementation should NOT be capitalized



# **Reporting and Disclosure of Municipal Debt**

Conduit Debt Obligations  
and  
What's Beyond GASB...

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# LSL Conduit Debt Obligations (Exposure Draft)

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- Goal of the Proposed Statement

***“Eliminating the existing option for issuers to report conduit debt obligations as their own liabilities, thereby ending significant diversity in practice.”***

# LSL Currently...

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NEWS > LOCAL NEWS

## Lake Forest breaks out the champagne



Lake Forest's new multi-building civic center complex is under construction and will be fully paid for with developer

By **ALICIA ROBINSON** | [arobinson@scng.com](mailto:arobinson@scng.com) | The Orange County Register  
PUBLISHED: October 12, 2018 at 10:07 am | UPDATED: October 12, 2018 at 10:07 am



*“The state controller’s data showed Los Angeles owed the most of any city, with \$24.5 billion in debt in 2015-16. Riverside’s comparatively modest total still was enough to rank it the seventh most indebted in the state, ahead of Anaheim (\$1.2 billion), Irvine (\$953.6 million) and Glendale (\$270.8 million). (Some cities have their own utilities, and that debt is included)”*

# LSL Currently... (continued)

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**City of Irvine**  
**Notes to the Basic Financial Statements**  
**For the Fiscal Year Ended June 30, 2016**  
(amounts expressed in thousands)

**III. Detailed Notes on All Funds (Continued)**

Non-committal debt amounts issued and outstanding at June 30, 2016, are as follows:

<u>Variable Rate Issues:</u>		<u>Bonds Issued</u>	<u>Bonds Outstanding</u>
07-22	Stonegate	\$ 40,000	\$ 7,905
05-21	Orchard Hills	79,265	31,644
04-20	Portola Springs	78,605	52,071
03-19	Northern Sphere	121,600	42,517
00-18	Shady Canyon/Turtle Ridge/Quail Hill	84,800	8,683
85-7	Irvine Spectrum	41,150	35,084
87-8	Spectrum 5	74,700	14,238
93-14	Spectrum 6 & 7	72,400	54,537
94-13	Oak Creek	61,600	16,231
94-15	Westpark II	32,700	3,577
97-16	Northwest Irvine	60,000	25,168
97-17	Lower Peters Canyon East	95,000	32,254
Total Variable Rate Issues		841,820	323,909
<u>Fixed Rate Issues:</u>		<u>Bonds Issued</u>	<u>Bonds Outstanding</u>
04-20	Portola Springs	7,450	-
04-20	Portola Springs	11,795	11,570
04-20	Portola Springs	14,460	14,460
04-20	Portola Springs	21,485	21,485
05-21	Orchard Hills	74,860	74,860
05-21	Orchard Hills	16,235	16,235
07-22	Stonegate	20,415	-
07-22	Stonegate	3,095	-
07-22	Stonegate	5,840	-
07-22	Stonegate	28,350	28,350
10-23	Laguna Altura	25,855	-
10-23	Laguna Altura	12,695	12,695
11-24	Cypress Village	38,655	38,377
13-25	Eastwood	34,430	34,430
11-1	Reassessment District	34,855	-
IPFLA	Revenue Bonds, 2012 Series A	33,570	-
12-1	Reassessment District	126,220	99,425
13-1	Reassessment District	80,755	72,655
15-1	Reassessment District	47,360	47,360
15-2	Reassessment District	50,625	50,625
CFD 2004-1	Central Park	18,510	18,510
CFD 2005-2	Columbus Grove	16,975	16,120
CFD 2013-3	Great Park	72,700	72,610
Total Fixed Rate Issues		797,190	629,767
Total All Issues		\$ 1,639,010	\$ 953,676

# LSL Proposed Statement – Conduit Debt

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- Definition

*“a debt instrument issued in the name of a state or local government but is for the benefit of a third party that is primarily liable for the repayment of the debt instrument.”*

- Six Characteristics

1. Three or more parties – issuer, 3<sup>rd</sup> party debtor, and trustee
2. Issuer and debtor not within the same financial reporting entity
3. Debt is not a parity bond of issuer, nor is cross-collateralized with other debt of issuer
4. Issuer does not ultimately receives proceeds from debt issuance
5. Issuer is not primarily obligated for debt repayment
6. Issuer has limited commitment to support debt payment

# LSL Proposed Statement – Conduit Debt

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# LSL<sup>CPAs</sup> Proposed Statement – Conduit Debt

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- Financial Statement Note Disclosure
  - Organize by type of commitment with general description of each commitment
  - General description of conduit debt obligation
  - Aggregate outstanding principal amount of all conduit debt for each type of commitment
  - Related liabilities and expense or expenditure recognized



## Effective Date

**Reporting periods beginning after  
December 15, 2020 (Fiscal Year 2020-  
21 for June 30 year-end)**

# LSL Reporting of Finance Authorities

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- Financing authorities are created by municipalities with power to issue tax-exempt bonds on city's behalf
- City and authority enter into an intergovernmental contract, and together engage in an indirect city-backed financing, such as lease revenue bonds
- By-laws of financing authority describes its authorities and define reporting structure
- Most often reported as blended component unit of the city
- State Controller's Report





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## Municipalities' Continuing Disclosure Responsibilities



- U.S. Securities and Exchange Commission (SEC) Rule 15c2-12
  - Official Statement (1989)
  - Annual filings and material event (11) notices (1994)
  - Use of single repository, MSRB and electronic document submission, or EMMA (2008 and 2010)
  - Events 15 and 16 (2018)
- State Reporting Requirements
  - CDIAC Annual Debt Transparency Report (SB1029, 2016)

# LSL Best Practices on Continuing Disclosure

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- Policy and Procedures
  - Incorporate into agency-wide Debt Policy
  - Stand-alone Disclosure Policy



- Professional Services
  - Rate monitoring
  - Continuing Disclosure Compliance (CDC) Review

