CHAPTER 11 – Debt Service Fund Accounting

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INTRODUCTION

This chapter provides information that is unique to the Debt Service Fund. Some information presented here may also be included in other parts of this manual, but it is included here so that those new to governmental accounting can obtain a general overview of each fund in one location.

As required by accounting standards, governmental accounting systems should be organized and operated on a fund basis. A fund is defined as a fiscal and accounting entity with a self-balancing set of accounts, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations. (See Chapter 1 Fund Accounting Systems, for additional information regarding fund accounting systems.)

The standards categorize funds into one of eleven fund types. These fund types are grouped into three general classifications:

- Governmental funds are used to account for tax-supported activities. GAAP establishes five governmental fund types; General Fund, Special Revenue Funds, Capital Projects Funds, Debt Service, and Permanent Funds. RCW 28A.320.330 requires school districts in Washington state to establish a General Fund, Capital Projects Fund, Debt Service Fund, and Associated Student Body Fund (Special Revenue Fund). RCW 28A.160.130 creates a Transportation Vehicle Fund (Capital Projects Fund).
- Proprietary funds are used to account for business-type activities of a government and are supported, at least in part, by fees or charges. Proprietary funds are **not** permitted for school districts in Washington State.
- Fiduciary Funds are used to account for resources in situations where the government is acting as a trustee or agent for parties outside the government. Fiduciary Funds *cannot* be used to support the government’s own programs. Fiduciary Activities are described in Chapter 13.

DEBT SERVICE FUND

Debt Service Fund—to account for the accumulation of resources for, and the payment of, general long-term debt principal and interest (GASB Cod. Sec. 1100.103a[4]. See also Sec. 1300, “Fund Accounting”).

School districts in the state of Washington have one Debt Service Fund. This fund has been established per RCW 28A.320.330 to account for the payment of principal, interest, and the expenditures related to the redemption of outstanding bonds and notes, as well as other noncurrent long-term liabilities. The county treasurer or fiscal agent makes payment of interest and principal.

Provision must be made annually for a levy sufficient to meet the payments of principal, interest, and related expenditures for voted debt. The levy should be sufficient to cover tax payment delinquencies. The state attorney general has ruled that it is improper to levy excessive taxes to retire bonds in advance of the redemption schedule (AGO 57-58 No. 230).

Non-voted bonds are also serviced in the Debt Service Fund rather than in the fund that received the debt proceed. In order to provide the resources to retire the debt, an operating transfer must be used by the General Fund, Capital Projects Fund, or Transportation Vehicle Fund to transfer resources to the Debt Service Fund.

The modified accrual basis of accounting is to be used in measuring financial position and operating results, except for unmatured principal and interest on general long-term debt which are not recorded as liabilities until they are due and payable. Except for unmatured principal and interest, expenditures are recorded whether disbursements have been made or not. When disbursements are made, the corresponding entries are reductions to the matured debt payable accounts. Since liability accounts have been established for the bond principal, bond interest, and transfer fees, subsidiary expenditure accounts as such are not necessary.

When bonds mature or interest payments become due, the matured debt is recorded in the expenditure accounts and in the matured debt accounts (General Ledger Account 675 Matured Bonds Payable and General Ledger Account 685 Matured Bond Interest Payable).

This section does not include information pertaining to the general ledger accounts (Chapter 4), or revenue accounts (Chapter 5). See the chapters indicated for detailed information in these areas.

Debt Service Fund Expenditures

The Debt Service Fund is provided to account for the revenues, other financing sources, other financing uses, and the related expenditures for long-term debt. This includes accounting for bond principal, interest, and other debt related expenditures.

All districts must recognize debt service expenditures on a modified accrual basis of accounting. When disbursements are made, the corresponding entries are reductions to the matured debt payable accounts. Since liability accounts have been established for the bond principal, bond interest, and transfer fees, subsidiary expenditure accounts as such are optional.

Debt issued with a maturity of one year or less should be accounted for in the appropriate fund due to its short-term nature. For discussion of the general ledger accounts applicable to the Debt Service Fund, see Chapter 4 General Ledger Accounts.

Transfer of State Forest Revenue From the Debt Service Fund to the Capital Projects Fund

RCW 28A.320.330(3) allows districts to transfer state forest land revenue that is in the Debt Service Fund (DSF) to the Capital Projects Fund (CPF) to the extent the state forest revenue is not necessary for payment of debt service on school district bonds. Districts may transfer past, present, or future state forest land revenue that meets the above requirements. If a district is in doubt about these requirements, they should consult their bond counsel.

Transfers are authorized by the adoption of a resolution of the board of directors. The district's board-adopted budget, if it accurately reflects the desired transfer, may serve as the required resolution for such transfer.

Once the required authorization is in place, budget and actual interfund transfers are accomplished in the accounting records using other financing source account codes in the Capital Projects Fund and other financing use account codes in the Debt Service Fund.

Introduction to Accounting for Advance Bond Refunding

Debt may be extinguished through refunding in addition to normal repayment. Refunding occurs when previously issued debt is retired at least in part by a new bond issue. Refunding is done to take advantage of lower interest rates and to modify debt service requirements. Often the proceeds from the sale of new bonds with a lower interest rate are used to pay off old bonds with a higher interest rate. Refunding is financially worthwhile when there is a significant savings on a present value basis as compared to the refunded bonds.

There are two types of bond refunding: current refunding and advance refunding. District bond counsel will generally refer to the federal tax law for guidance on refundings. Under an advance refunding structure, the proceeds of the refunding issue are invested in an escrow account held by a trustee until the old bonds can be redeemed. In structuring an advance refunding, an issuer calculates an issue size which, together with interest earnings in the escrow account, will be sufficient, after payment of issuance costs, to pay principal and interest requirements, as well as any call premium, on the refunded bonds.

Chapter 39.53 RCW, known as the Refunding Bond Act, authorizes refunding of bonds. Four provisions of chapter 39.53 RCW are:

- RCW 39.53.020 authorizes refunding without an election.
- RCW 39.53.050 authorizes refunding bonds to be issued in a principal amount in excess of, less than, or the same as the principal amount of the bonds to be refunded.
- RCW 39.53.090 states that the principal amount of annual maturities may be increased to the nearest $5,000 for the purpose of rounding out maturities.
- RCW 39.53.100 states that the amounts of money and investments on deposit for bond retirement shall be deducted from the computation of the amount of outstanding indebtedness for the purpose of any constitutional or statutory debt limitation.

A school district's bonds cannot be redeemed until they can be called or until they have matured and are payable. There are two ways to structure the advance refunding of bonds. One is the regular method and the second is the crossover method. Both methods of refunding result in either a legal or an in-substance defeasance. For financial reporting purposes, a defeasance is the removal of debt and related assets from the balance sheet prior to the actual redemption of the debt.

A legal defeasance is rare in the government environment and generally occurs 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. An in-substance defeasance is achieved when cash or assets that qualify as "essentially risk free as to amount, timing and collection of principal and interest" are deposited in an irrevocable trust. These assets for an in-substance defeasance should provide cash flows that are sufficient and timed to match the scheduled interest and principal payments on the debt that is being extinguished.

Generally, in-substance defeasances are accomplished through the purchase of state and local government series (SLGS) securities. SLGS securities can provide adequate cash flows that coincide with the refunded obligation's debt service schedule without exceeding the Internal Revenue Code arbitrage limits established by the 1986 Tax Reform Act.

If refunding bonds are issued in a principal amount in excess of the principal amount of the bonds to be refunded, as authorized in RCW 39.53.050, the amount of the excess is to be considered nonvoted debt in debt limit calculations. Because of this stipulation, school districts should calculate both their nonvoted and voted debt limits whenever there is a bond refunding. The bond counsel typically does this.

The remainder of this section explains the accounting and financial reporting of the regular and crossover methods of refunding.

BOND ISSUE AND BOND REFUNDING JOURNAL ENTRIES

Bond issues and bond refundings are common debt instruments for governments to obtain long-term financing. Provided in this section is an example that will help you answer some of those questions. Not all situations can be covered in this section, although the information may help you deduce how to journalize the transaction. If you need additional assistance, contact the School District Accounting Supervisor at OSPI or your ESD.

Closing Memorandum: When issuing bonds and refunding bonds the bonding company will issue you a document most commonly called a "Closing Memorandum." This closing memorandum is the document you will most likely use to make your journal entries to record the issuance or refunding of your bonds.

This closing memorandum will contain the date the bonds were issued, the date the bonds were sold, and when and where the closing will occur. Note the date the bonds are issued and the date the bonds are sold. The difference in these dates will result in a journal entry for the accrued interest on the bonds.

Below are more explanations of terms commonly contained in the closing memorandum. After the terms, there is an example of a closing memorandum, followed by a worksheet showing the journal entry of each transaction.

Bond Issues

Principal Amount or Par Value or Face Value: This is the issue amount of the bonds. This amount is an increase in cash to the fund issuing the bonds, in this example, the Capital Projects Fund (see Item #1 in the following bond issue example). Bonds may be issued for more than par or face, which is called a premium on bonds, and sometimes they may be issued at a discount or below the par or face value. In our example below, the bonds are issued at a premium. See "Additional Proceeds" in the following bond issue example (credit to GL 965).

Cost of Issuance: Fees or other costs associated with issuance of the bonds. These fees may be paid out of the proceeds from the issuance through an electronic transfer of funds or the district may receive funds earmarked to pay these cost of issuance fees. If the district receives these funds, the district will receive an invoice requesting payment of these funds from the underwriter. In the following example, the funds are recorded as a debit to cash and a credit to bond proceeds in the Capital Projects Fund. See Item #2 in the following bond issue example. If these costs of issuance are paid at the time the bonds are issued, the district would recognize the payment of these costs with a debit to GL 530.

Additional Proceeds or Premium: Sometimes bonds are sold for more than par or face value. This is due to interest rates and fluctuations in the market. If the bond is offering an interest rate that is better than the going market rate, this will make the bonds more attractive to the purchaser who may be willing to pay more than the bond's par value due to the better rate of return they would get on their investment. This premium is additional proceeds that are used to help pay for costs of issuance and other fees, with any remaining premium proceeds being deposited into the Debt Service Fund to help service the debt payments when they come due. See Item #3 in the following bond issue example (credit to GL 965).

Bond Discount: The opposite of bond premiums may occur and the bonds may be sold at a discount, meaning less than "par value." In these cases, the discount should not be netted against the proceeds of the bonds, but recorded as an Other Financing Use in GL 535 Other Financing Uses (Actual).

Accrued Interest: The issue date of the bonds and the date the bonds are sold (or the closing date) may not be the same. The bond starts to accrue interest the day they are issued. Since the bonds are sold at a date after the issue date, the interest on the bonds between these two dates must be accrued. This accrued interest is debited to cash and credited to bond interest payable (GL 604) in the Debt Service Fund. See Item #4 in the following bond issue example.

Note: GL 604 Accrued Interest Payable should be closed when the first payment on new bonds is made.

Examples of Other Types of Issuance Costs are:

Underwriter's Discount (Fees): A portion of the proceeds may be withheld for underwriter's fees (most commonly called underwriter discount), due in connection with the debt issuance. This should not be netted against the proceeds of the bonds. This amount should be reported as an expenditure. See Item #5 in the following bond issue example. This is shown as a debit to GL 530 and a credit to GL 965.

Financial Advisor Fee: This is an expenditure that the financial advisor will charge for their services on the bond issue. See Item #6 in the following bond issue example. This is shown as a debit to GL 530 and a credit to GL 965.

Bond Insurance Premium: This is an expenditure that the bond insurance company will charge for their part in the bond issue. This is also an expenditure usually in the fund that is issuing the bond. See Item #7 in the following bond issue example. This is shown as a debit to GL 530 and a credit to GL 965.

NOTE: Bond premium or bond discounts, must be amortized over the life of the bond (the effective interest rate method).

Bond Issue Example

Closing Memorandum

Re: Sutherland School District No.123
Sutherland County, Washington
$9,500,000 Unlimited Tax General Obligation Bonds, 20XX
Dated Date: May 15, 20XX

From: Joan Jett, Public Finance Sr. Associate
Sutherland Securities Corporation

Date: May 17, 20XX

Closing
Closing will occur at 9:00 a.m., Wednesday, May 25, via conference call initiated by Grapes, Oranges, and Apples PLLC.

Funds
Sutherland Securities Corporation will initiate the following transactions:

<u>Transaction #1</u>

Amount:	$9,634,601.93 (Federal Funds)
To:	Bank of Sutherland
ABA Number:	123456789
Account Number:	55512121
Reference:	Sutherland School District No. 123, UTGO Bonds, 20XX
Attention:	John Doe, XXX-555-7890

<u>Transaction #2</u>

Amount:	$17,812.20 (Federal Funds)
To:	The Bank of New York
ABA Number:	987654321
Account Number:	12121555
Reference:	Sutherland School District No. 123, UTGO Bonds, 20XX
Attention:	Carmen Miranda, XXX-555-5893

Transaction #3

Amount:	$23,750.00 (Federal Funds)
To:	Peoples Bank
ABA Number:	456789023
Account Number:	21219981
Reference:	Sutherland School District No. 123, UTGO Bonds, 20XX
Attention:	Jack Blank, XXX-555-7734

The following is a summary of the sources of funds for the 20XX Bonds and how those funds will be applied by the county, the financial advisor, and the insurer:

Sources of Funds

Principal Amount	$9,500,000.00	
Plus: Accrued Interest (May 15–May 25)	11,009.38	
Plus: Original Issue Premium*	*212,654.75	9
Less: Original Bond Discount	<1,000.00>	8
Less: Underwriter's Discount	<46,500.00>	5
Total Sources of Funds:	$9,676,164.13	

Distribution of Funds

Sutherland County Treasurer's Office		
Capital Projects Fund Deposits	$9,500,000.00	1
Cost of Issuance (Deposit to District Capital Projects Fund)	24,500.00	2
Additional Proceeds (Deposit to District Debt Service Fund)	99,092.55	3
Accrued Interest (Deposit to District Debt Service Fund)	11,009.38	4
Total to Sutherland County:	9,634,601.93	
ABC Financial Services		
Financial Advisor Fee	23,750.00	6
Financial Insurance Co.		
Bond Insurance Premium	17,812.20	7
Total Funds Disbursed:	$9,676,164.13	

*Note: This amount is split: Capital Projects Fund (Item 9A) = $113,562.20; Debt Service Fund (Item 9B) = $99,092.55. See Items 9A and 9B on the next page.

Bond Issue Journal Entry Example

Capital Projects Fund					
General Ledger Account	Account Title	Debit	Credit	Description	Item #
240	Cash on Deposit With County Treasurer	9,500,000.00		Par value of new bonds	1
240	Cash on Deposit With County Treasurer	24,500.00		Additional proceeds to cover bond issue costs	2
530	Expenditures	46,500.00		Underwriter's Discount**— Bond issue cost	5
530	Expenditures	23,750.00		Fee—Bond issue cost	6
530	Expenditures	17,812.20		Insurance premium— Bond issue cost	7
535	Other Financing Uses (Budget and Actual)	1,000.00		Original Bond Discount*	8
965	Other Financing Sources		9,500,000.00	Par value of new bonds— Proceeds from bonds	1
965	Other Financing Sources		113,562.20	Original issue premium— Proceeds from bonds	9A
		9,613,562.20	9,613,562.20		

Debt Service Fund					
General Ledger Account	Account Title	Debit	Credit	Description	Item #
240	Cash on Deposit With County Treasurer	99,092.55		Premium on Bond	9B
240	Cash on Deposit With County Treasurer	11,009.38		Accrued interest	4
965	Other Financing Sources		99,092.55	Original issue premium	9B
604	Accrued Interest Payable		11,009.38	Accrued interest	4
		110,101.93	110,101.93		

Note: GL 604 should be closed when the first interest payment on new bonds is made.

* Original Bond Discount or Premium = the difference between stated and market rate.

**Underwriter's Discount = underwriter's fees or costs.

Bond Refunding

Often bonds that have been issued are replaced by a new issue of bonds. This is called a refunding. Some of the common reasons why a district would refund bonds are to take advantage of better interest rates or to avoid cumbersome bond covenants.

GAAP require that the proceeds of current or advance refunding be reported as an Other Financing Uses (Budget and Actual) in GL 535. However, in an advance refunding, if an additional amount is required to be placed in an escrow together with the proceeds of the new debt (refunding debt), the additional amount must be reported as a debt service expenditure (GL 530).

Current Refunding: This is where the proceeds of the new debt (refunding debt) are used to immediately redeem the old debt (refunded debt).

Advance Refunding: In the case of advance refunding, the proceeds of the new debt (refunding debt) are placed in an escrow account pending the call date or maturity of the old debt (refunded debt).

Crossover Refunding: Most Advance refundings result in either the legal or in-substance defeasance of the old debt. An exception to this general rule occurs in the case of crossover refundings, which are similar to other types of advance refundings in most respects (that is, refunding bonds are issued, and their proceeds are placed into an escrow account). Unlike other types of advance refundings, however, the escrow account in a crossover refunding transaction is not immediately dedicated exclusively to debt service principal and interest payments on the old debt. Instead, the resources in the escrow account also are used for a time to fund principal and interest payments on the refunding bonds themselves. Only at a predetermined future date, known as the crossover date, do the resources in the escrow account come to be dedicated exclusively to the payment of principal and interest on the old debt.

Consequently, crossover refundings do not meet the criteria for an in-substance defeasance. These conditions may be met later, however, at the predetermined crossover date. Until that time, both the old debt and the assets of the related escrow account must continue to be reported on the face of the financial statements, as no defeasance is considered to have occurred (2005 GAAFR page 107).

Defeasance: Most Advance refundings result in “defeasance,” which is an accounting term for treating the debt as if it has already been redeemed. 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 on the face of the financial statements; only the new debt is reported as a liability (GASBS 7, paragraph 3, as amended by GASBS 34, paragraph 6; GASBS 23, fn 1).

Principal Amount or Par Value: This is the amount the bonds are worth. In a refunding, the principal amount is credited to General Ledger Account 965 Other Financing Sources and Revenue Account 9600 Sale of Refunding Bonds in the Debt Service Fund; this replaces the old debt. See Item #1 in the following bond refunding example.

Original Issue Premium: As with a bond issue, sometimes bonds are sold for more than their "par value." This is due to interest rates and fluctuations in the market. If the bond is offering an interest rate that is better than the going market rate, this will make the bonds more attractive to the purchaser who may be willing to pay more than the bonds par value due to the better rate of return they would get on their investment. This premium is recorded in the Debt Service Fund again as a credit to General Ledger Account 965 Other Financing Sources. See Item #2 in the following bond refunding example.

Underwriter's Discount (Fees): A portion of the proceeds may be withheld for underwriter's fees (most commonly called underwriter discount), due in connection with the debt issuance. This should not be netted against the proceeds of the bonds. The discount resulting from the withholding should be recorded as an expenditure by debiting General Ledger Account 530 Expenditures in the Debt Service Fund. See Item #3 in the following bond refunding example.

Additional Proceeds: Funds received in the Debt Service Fund as a result of the bonds being sold at a premium. This is cash received; therefore, is recorded as a debit to General Ledger Account 240 Cash on Deposit with County Treasurer in the Debt Service Fund. See Item #4 in the following bond refunding example.

Escrow Amount: This is the total amount of the refunding which is deposited to the escrow account. This amount is debited to General Ledger Account 535 Other Financing Uses (Actual) in the Debt Service Fund. See Item #5 in bond refunding example.

Escrow Beginning Cash Deposit: Many banks require a small deposit to open the escrow account. This amount on the closing memorandum is recorded as a debit to

General Ledger Account 535 Other Financing Uses (Actual) in the Debt Service Fund. See Item #6 in bond refunding example.

Cost of Issuance: Fees or other costs associated with issuance of the bonds. This is an actual expenditure and should be recorded as such. The district will record a debit to General Ledger Account 530 Expenditures in the Debt Service Fund. See Item #7 in bond refunding example.

Bond Insurance Premium: This is an expenditure that the bond insurance company will charge for their part in the bond issue. The district will record a debit to General Ledger Account 530 Expenditures in the Debt Service Fund. See Item #8 in bond issue example.

Bond Refunding Example

Closing Memorandum

Re: Diamond Bar Public Schools (District No. 432)
Barstow County, Washington
$3,780,000 Unlimited Tax General Obligation Bonds, 20XX
Dated Date: July 1, 20XX

From: J. Lazar, Public Finance Sr. Associate
Big Wheel Securities Corporation

Date: June 27, 20XX

Closing
Closing will occur at 9 a.m., Friday, July 1, via conference call initiated by Moreland, Nanini, and Gray LLP.

Funds
Happy Planet Securities Corporation will initiate the following transactions:

<u>Transaction #1</u>

Amount:	$3,413.20 (Federal Funds)
To:	Bank of Barstow
ABA Number:	123456789
Account Number:	55512121
Reference:	Diamond Bar Public Schools, UTGO Bonds, 20XX
Attention:	P. Wexstun, XXX-555-7890

Transaction #2

Amount:	$3,846,267.17 (Federal Funds)
To:	The State Line Bank
ABA Number:	987654321
Account Number:	12121555
Reference:	Diamond Bar Public Schools, UTGO Bonds, 20XX
Attention:	Standard Ridgeway, XXX-555-5893

Transaction #3

Amount:	$8,672.03 (Federal Funds)
To:	Bank of the West
ABA Number:	456789023
Account Number:	21219981
Reference:	Diamond Bar Public Schools, UTGO Bonds, 20XX
Attention:	Rick King, XXX-555-7734

The following is a summary of the sources of funds for the 20XX Refunding Bonds and how those funds will be applied by the county, the escrow agent, and the insurer:

Sources of Funds

Principal Amount	$3,780,000.00	1
Plus: Original Issue Premium	103,035.80	2
Less: Underwriter's Discount	<24,683.40>	3
Total Sources of Funds:	$3,858,352.40	

Distribution of Funds

Barstow County Treasurer's Office

Additional Proceeds (Deposit to District Debt Service Fund)	$3,413.20	4

Burt Charlie Escrow Agent

Deposit to Escrow Account by U.S. Government Securities	3,827,766.00	5
Escrow Beginning Cash Deposit	1.17	6
Cost of Issuance	18,500.00	7
Total to Escrow Agent:	3,846,267.17	

Financial Assurance Co.

Bond Insurance Premium	8,672.03	8
Total Funds Disbursed:	$3,858,352.40	

Bond Refunding Journal Entry Example

Debt Service Fund					
General Ledger Account	Account Title	Debit	Credit	Description	Item #
240	Cash on Deposit With County Treasurer			Premium on bond	
240	Cash on Deposit With County Treasurer			Accrued Interest	
240	Cash on Deposit With County Treasurer	3,413.20		Additional funds	4
530	Expenditures	18,500.00		Bond issue cost	7
530	Expenditures	8,672.03		Insurance premium—Bond issue cost	8
530	Expenditures	24,683.40		Underwriters discount—Bond issue cost	3
535	Other Financing Uses (Budget and Actual)	3,827,766.00		Deposit to refunding escrow	5
535	Other Financing Uses (Budget and Actual)	1.17		Deposit to refunding escrow	6
965	Other Financing Sources		3,780,000.00	Par value of new bonds—Proceeds from bonds	1
965	Other Financing Sources		103,035.80	Original issue premium—Proceeds from bonds	2
604	Accrued Interest Payable			Accrued Interest	
		3,883,035.80	3,833,035.80		

Journal Entries for the Regular Method of Advance Bond Debt Refunding

Entry #1

General Ledger Account	Subsidiary Ledger Required	Account Title	Debit	Credit
535		Other Financing Uses (Budget and Actual)—Payment to Refunded Bond Escrow Agent	510,000	
965	Yes	Other Financing Sources—Sale of Refunding Bonds		510,000
To record the proceeds from the sale of the refunding bonds and the payment to the refunded bond escrow agent to defease the old debt. *This entry also includes $10,000 in both the Other Financing Uses and Other Financing Sources accounts for underwriting fees. If the school district receives the cash from the sale of the refunding bonds, this entry would be split into two entries that would include a debit to cash for the receipt of the proceeds and a credit to cash to record the payments to the escrow agent and to the underwriter.*				

***Districts that opt to maintain a Long-Term Debt "holding account" should record the following collateral entries in that account:*

General Ledger Account	Subsidiary Ledger Required	Account Title	Debit	Credit
480		Amount to be Provided for Debt Retirement	500,000	
690		Bonds Payable—Long-Term (New Bonds)		500,000

Entry #2

General Ledger Account	Subsidiary Ledger Required	Account Title	Debit	Credit
530	Yes	Expenditures	10,000	
601	Yes	Accounts Payable		10,000

To record debt issuance expenditures from the Debt Service Fund's current resources for the underwriter's fees. If the underwriter's fees are deducted from the proceeds of the refunding bonds, Entry #1 is to be used.

Journal Entries for the Crossover Method of Advance Bond Debt Refunding

Entry #3

General Ledger Account	Subsidiary Ledger Required	Account Title	Debit	Credit
250		Cash With Fiscal Agent	500,000	
965	Yes	Other Financing Sources—Sale of Refunding Bonds		500,000
To record the amount placed in escrow as the result of a crossover refunding bond issue.				

***Districts that opt to maintain a Long-Term Debt "holding account" should record the following collateral entries in that account:*

General Ledger Account	Subsidiary Ledger Required	Account Title	Debit	Credit
690		Bonds Payable—Long-Term (Old Bonds)	500,000	
470		Amount Available in Debt Service Fund		500,000

Entry #4

General Ledger Account	Subsidiary Ledger Required	Account Title	Debit	Credit
535		Other Financing Uses (Budget and Actual)—Crossover Defeasance	500,000	
250		Cash With Fiscal Agent		500,000
To record the amount placed in escrow as the result of a crossover refunding bond issue.				

*** Districts that opt to maintain a Long-Term Debt "holding account" should record the following collateral entries in that account:*

General Ledger Account	Subsidiary Ledger Required	Account Title	Debit	Credit
480		Amount to be Provided for Debt Retirement	50,000	
690		Bonds Payable—Long-Term		50,000

Entry #5

General Ledger Account	Subsidiary Ledger Required	Account Title	Debit	Credit	Source
240		Cash On Deposit With County Treasurer	2,975		Accrued interest
240		Cash On Deposit With County Treasurer	3,925		Additional proceeds to debt service (new bond)
530	Yes	Expenditures	19,100		Payment of issue costs
530	Yes	Expenditures			Bond insurance premium (if any)
530	Yes	Expenditures	19,150		Underwriter's discount
530	Yes	Expenditures		2,975	Accrued interest
535		Other Financing Uses (Budget and Actual)	1,936,420		Deposit to escrow
535		Other Financing Uses (Budget and Actual)	5		Deposit to escrow
965	Yes	Proceeds From Bonds		1,980,000	Par value of new bonds
965	Yes	Proceeds From Bonds	1,400		Original issue discount (premium)
965	Yes	Proceeds From Bonds			Rounding of split costs
			1,982,975	1,982,975	
To record bond refunding.					

Note: GL 604 could be used for accrued interest if not done in the same fiscal year. If this is done, it is important the entry be reversed the next year.

Questions and Answers on the Regular Method of Advance Bond Refunding

How is the regular method of advance bond refunding structured?

The proceeds from the sale of refunding (new) bonds are placed in the custody of the trust department of a bank through the county treasurer. The bank establishes an escrow account and invests the proceeds so that the cash realized from the maturing investments, together with interest earned, will meet the debt service requirements of the refunded (old) bonds, and to redeem the balance of the old bonds when they become callable or mature. The bank reports the financial activity in the escrow account to the county treasurer. Each school district will need to work with its county treasurer to determine whether the school district or the county treasurer will verify the accuracy of the amounts reported and that the transactions were done in accordance with the escrow instructions. The county treasurer shows the refunding financial activity on the County Treasurer's Monthly Report (F-197). The school district is legally responsible for the verification of the amounts reported on the F-197.

How are the refunded (old) bonds accounted for?

The old bonds are removed from the long-term debt liability of the school district. The bonds are placed in the custody of the trust department of a bank through the county treasurer. The bank establishes an escrow account to meet the debt service requirements of these bonds.

How are the refunding (new) bonds accounted for?

The new bonds are entered as a long-term debt liability of the school district debt and the debt service on the new bonds is recorded in the school district's Debt Service Fund.

What are the tax levy requirements?

Taxes are no longer levied for the debt service requirements of the refunded (old) bond issue. Instead, taxes are levied for the debt service requirements of the refunding (new) bond issue together with any other bonds that have not been refunded.

What are the budgeting and financial reporting requirements?

The debt service requirements of the refunding (new) bonds are budgeted and reported in the school district's Debt Service Fund. The unmatured new bonds are reported as a long-term debt liability of the school district. The school district does not budget or report any debt service on the refunded bonds or the amount of the refunded bonds outstanding. The amount of the refunded debt outstanding should be disclosed in a note to the school district's financial statements because the debt is a contingent liability of the school district.

A general description of the transaction should be included in the notes to the financial statements in the year of the refunding. At a minimum, the disclosures should include (1) the difference between the cash flows required to service the old debt and the cash flows required to service the new debt to complete the refunding and (2) the economic gain or loss resulting from the transaction.

Questions and Answers on the Crossover Method of Advance Bond Refunding

How is the crossover method of advance refunding structured?

The proceeds of the refunding (new) bonds are placed in the custody of the trust department of a bank through the county treasurer. The bank establishes an escrow account where the proceeds are converted to investments and the investment earnings are used to pay the interest on the new bonds until the refunded (old) bonds are callable or mature. When the call date or maturity date arrives, the old bonds are redeemed with the resources in the escrow account. After the old bonds are redeemed, the source of revenue applicable to the old bonds is used to service the new bonds. The bank reports the financial activity in the escrow account to the county treasurer who verifies the accuracy of the amounts reported and that the transactions were done in accordance with the escrow instructions. The county treasurer shows the refunding financial activity on the County Treasurer's Monthly Report (F-197). The school district is legally responsible for verifying the amounts reported on the F-197.

How are the refunded (old) bonds accounted for?

Until the crossover date, which is generally when the old debt matures or can be called, the debt service on the refunded bonds continues to be recorded in the school district's Debt Service Fund and the unmatured amount of the refunded bonds is recorded in the district's long-term debt. When the crossover date arrives, the refunded bonds are removed from the school district's long-term debt and are placed in custody of the trust department of a bank through the county treasurer. The refunded bonds are then redeemed with the proceeds from the sale of the new bonds that were placed in the escrow account when the new bonds were sold.

How are the refunding (new) bonds accounted for?

The new bonds are entered into the school district's long-term debt at the time they are sold. Until the crossover date, which is when the refunded (old) debt matures or can be called, the debt service on the new bonds is recorded in a bank escrow account. The bank reports the debt service on the new bonds and the amount of the new bonds outstanding to the county treasurer. After the crossover date and the refunded bonds have been redeemed, the new bonds continue to be recorded in the school district's long-term debt and the debt service on the new bonds is then recorded in the school district's Debt Service Fund.

What are the tax levy requirements?

Until the crossover date, taxes are levied for the debt service requirements of the bond issue to be refunded. After the crossover date, taxes are levied for the debt service requirements of the refunding (new) bond issue, together with any other bonds that have not been refunded.

What are the budgeting and financial reporting requirements?

Until the crossover date, the debt service requirements of the bonds to be refunded are budgeted and reported in the school district's Debt Service Fund and both the refunded and new debt are to be reported in the school district's financial statements as part of the long-term debt. Until the crossover date, the new debt is ***not*** to be included in the computation of indebtedness for the purpose of any constitutional or statutory debt limit, even though it is reported as long-term debt. After the crossover date, the new bonds are budgeted and reported in the school district's Debt Service Fund and the new bonds continue to be reported in the school district's financial statements as part of the long-term debt. After the crossover date, any debt service requirements on the refunded bonds are neither budgeted nor reported by the school district and the old bonds are no longer reported in the school district's long-term debt. Generally, at the crossover date the refunded bonds are redeemed with the resources in the bank's escrow account. However, any amount of the old debt still outstanding should be disclosed in a note to the school district's financial statements because the debt is a contingent liability of the school district.

A general description of the transaction should be included in the notes to the financial statements in the year of the refunding. At a minimum, the disclosures should include: (1) the difference between the cash flows required to service the old debt and the cash flows required to service the new debt and complete the refunding; and (2) the economic gain or loss resulting from the transaction.