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Accounting for Debt

Dear Reader:

The following document was created from the CTAS website (ctas.tennessee.edu). This website is maintained by CTAS staff and seeks to represent the most current information regarding issues relative to Tennessee county government.

We hope this information will be useful to you; reference to it will assist you with many of the questions that will arise in your tenure with county government. However, the *Tennessee Code Annotated* and other relevant laws or regulations should always be consulted before any action is taken based upon the contents of this document.

Please feel free to contact us if you have questions or comments regarding this information or any other CTAS website material.

Sincerely,

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Accounting for Debt

Reference Number: CTAS-1752

Budgets

Reference Number: CTAS-1753

Budgets are plans of financial activity anticipated over a period of time to support a plan of service. From the government perspective, budgets are in two major categories: Operating Budgets and Capital Budgets.

Operating Budgets

An operating budget is annually developed and approved by the local government for the receipts and expenditures of funds during a 12-month timeframe beginning July 1 and ending June 30 (fiscal year). The operating budget is the government's plan of services depicted in financial estimates of revenues and anticipated expenditures. The expenditures would include salaries, supplies and materials, interest and principal on outstanding debt, and other current period (fiscal year) operating expenses. The duration of an operating budget is 12 months. Operating funds are separate accounting entities where certain activities are accounted for independently with their own financial statements of balance sheets and statements of revenue and expenditures. Examples of operating funds would be the General Fund, Solid Waste Fund, Highway and Road Fund, School Funds and the Debt Services Funds. Specifically note that debt services funds are operating budgets in that these funds account for the 12-month period of the fiscal year's revenue and expenditures (payment of interest and principal).

Capital Budgets

A capital budget is a finance plan and program to purchase or contract for purchase items (or the construction of items) that are expensive in cost and have a long life expectancy of use. Examples of items in a capital improvements budget would be land, buildings, large expensive pieces of equipment, major expansions of buildings, major renovations of buildings and equipment. Generally the funding for capital items comes from the issuance of debt by bonds, notes, and in limited cases, annual revenue. A capital budget usually exceeds 12 months, and always extends until the completion of the specific project.

Recommended Practice: Establish a Capital Budget

Debt Service Budgets/Funds

Most all county governments at some time or other have borrowed money, and thus issued debt instruments. Upon the issuance of debt, county governments are generally required to establish, and have a separate accounting for, the receipts of revenues (property taxes and other revenue sources) and the expenditures of paying of the principal and interest payment on the indebtedness. This separate account/ fund(s) is known as the Debt Service Fund. The Debt Service Fund is an operating fund. Upon the establishment of the fund, annual budgets must be adopted to reflect the anticipated activity of annual revenues and expenditures. The debt service funds are used exclusively for the payment of principal and interest; however, principal and interest do not exclusively have to be paid out of the debt service funds. Generally, it is the best practice to have all debt paid from the Debt Service Fund. However, we recognize that in certain circumstances a county may have the school system and/or highway department pay their debt directly from their respective funds.

Recommended Practice: Payments of all Debt from the Debt Service Funds

Annual Comptroller Approval of Operating Budgets

Various statutes in Tennessee require local governments to adopt budgets at the beginning of each fiscal year. If a county has outstanding debt, an annual budget must be submitted to the Comptroller Office Division of Local Finance for approval. The Comptroller has prescribed the requirement and form in which the budget must be submitted. For further information, see Procedures under the Operating Budget topic.

Fund Structure

Reference Number: CTAS-1758

The fund structure has been established by the Comptroller of Tennessee. The structure of accounts is known as a Uniform Chart of Accounts. It is used in each county of the state with some variations. The operating funds, which include the debt service funds, work in unison with the capital project funds. See Chart of Accounts under the Operating Budget topic for more information.

<u>The Comptroller’s Chart of Accounts regarding Debt Service</u>

The County Uniform Chart of Accounts used to assist in accounting for financial activities related to the payment of debt, has established seven operating funds with account numbers set aside for additional funds if needed. These funds are as follows:

151	General Debt Service
152	Rural Debt Service
153	Industrial Debt Service
154	Special Debt Service
155	Hospital Debt Service
156	Education Debt Service
157	School Bond Trust
158 - 169	Other Debt Service funds

<u>The Comptrollers’ Chart of Accounts Regarding Capital Projects</u>

The County Uniform Chart of Accounts used to assist in accounting for financial activities related to using capital project funds, has established eight capital funds with account numbers set aside for additional funds if needed. These funds are as follows:

171	General Capital Projects
172	Community Development/Industrial Park
173	Sanitation Projects
174	Nursing Home Projects
175	HUD Grant Projects
176	Highway Capital Projects
177	Education Capital Projects
178 - 188	Other Capital Projects funds
178	Other Capital Projects

<u>The Comptroller’s Chart of Accounts that encompass all Operating and Capital Funds</u>

The County Uniform Chart of Accounts is used to account for all financial activities of the government. Certain account codes can be used in any fund. The Chart of Accounts has been established by a three-digit fund number; a five-digit revenue number for the revenue side of the ledger; a five-digit function (also known as department or line item) for expenditure departments; and a digit object code for the expenditures’ details.

The following would be an example of a General Debt Service Revenue and Expenditure budget:

151 General Debt Service

Revenue
40110 Current Property Tax

Expenditures
82110 Principal on General Government
601 Principal on Bonds
602 Principal on Notes
82210 Interest on General Government
603 Interest on Bonds
604 Interest on Notes

Debt Service Accounting Relationship

Reference Number: CTAS-1759

Figure 4 shows the Debt Service Accounting relationship. Figure 5 shows the Flow of Money relationship. In summary, monies are borrowed from banks and financial institutions and receipted into an operating fund (other than debt service) or capital fund(s). These operating funds or capital funds are used to purchase the asset(s). The indebtedness due to the borrowed monies is then paid annually by the retiring of this debt by way of the annual debt service operating budget.

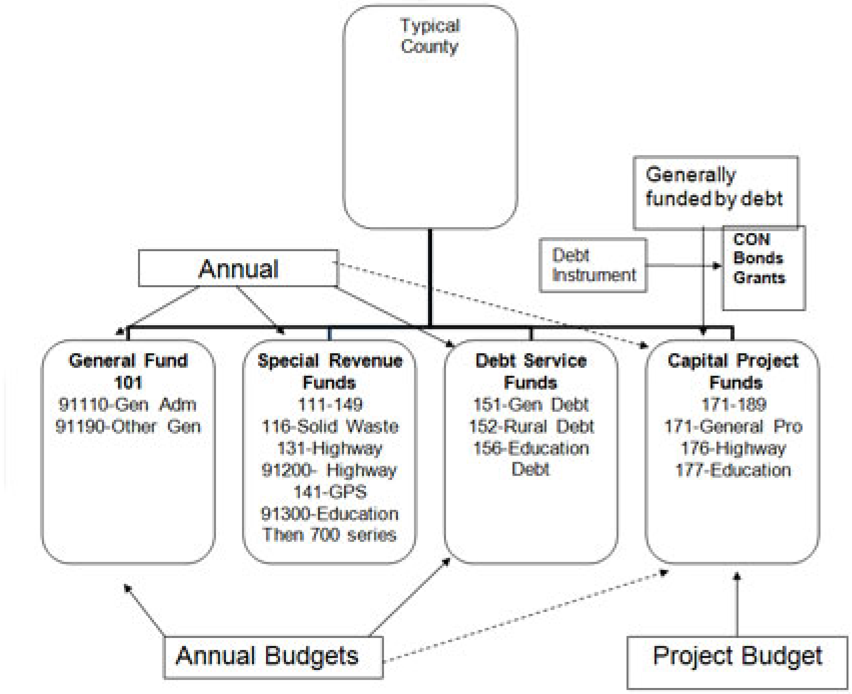

Figure 4

Flow of Money-The Debt Service Fund

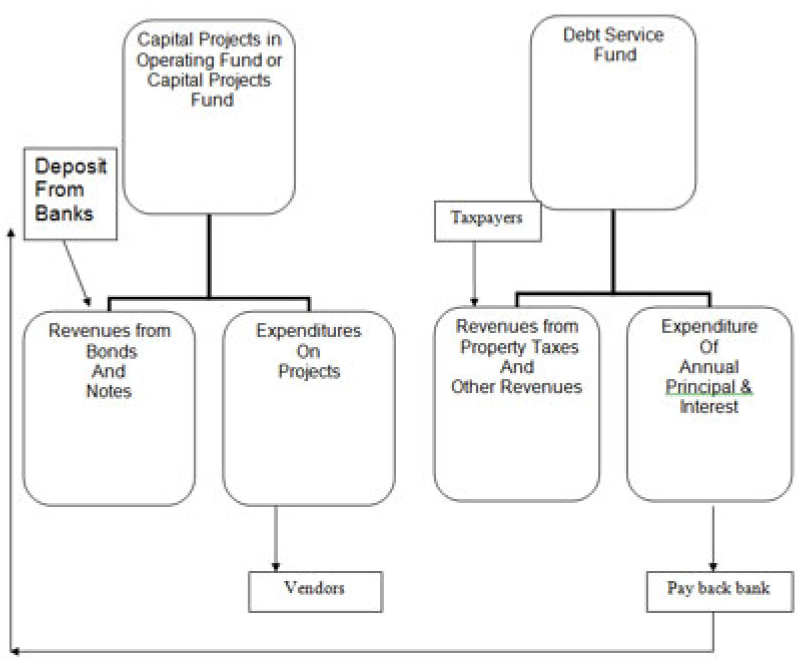

Figure 5

Unfunded Pension or Other Post Employment Benefits (OPEB)

Reference Number: CTAS-1760

Unfunded pensions and Other Post Employment Benefits (OPEB) are considered an obligation of a county, and generally are long term in nature. These obligations were established when a government made promises to employees to be paid out at a future time with future revenues. These promises, in one sense, are no different than the current promise to pay obligations of notes, bonds and leases. However, the treatment of unfunded pensions and OPEB are entirely different. Further, most Tennessee county governments are members of the Tennessee Consolidated Retirement System that holds the retirement assets, and thus these liabilities. If any unfunded pensions exist, they are held by the retirement system. County obligations, if any, are OPEB. An example is when a county has promised retired employees that the local government will pay a portion of the health insurance premium until the retired employees are Medicare eligible. Thus the employee is no longer working, but is receiving benefits where the cost of the benefits has not been set aside into a trust. Tennessee law allows a local government to issue debt for certain unfunded pension obligation (reference T.C.A. § 9-21-127).

Legal Authority Guidance

Reference Number: CTAS-1761

Tennessee Code Annotated (T.C.A.) Title 9, Chapter 21 and Title 12, Chapter 10 specifically address the issuance of debt and related budget requirements. Further the Comptroller of the Treasury Division of Local Finance publishes a “Guide for the Issuance of Notes by the Counties, Consolidated Governments and Municipalities of Tennessee” as a reference for the issuance of notes.

Accounting Posting for the Receipt of Borrowed Funds

Reference Number: CTAS-1762

For the accounting staff that will be posting the accounting records for the county, the following journal entries (figures 6, 7, 8 and 9) would typically be found.

For Monies to be Received into the General Capital Projects Fund

Figure 6

					Debit	**Credit**
Balance Sheet						
	171	11140		Cash with Trustee	$9,675,000.00	
Expenditures						
	171	91100	605	Underwriter’s Discount	$125,000.00	
	171	91100	606	Other Debt Issuance Charges	$200,000.00	
Revenue						
	171	49100		Bond Proceeds		$10,000,000.00
To Record the issuance of $10,000,000 of Bonds for General Capital Projects						

For Monies to be Received into the Education Capital Project Fund

Before we list the accounting postings, note that these postings can vary from accounting system to accounting system. Also note that the recommended postings have changed in the last number of years due to the implementation of GASB #34. Since boards of education do not have debt issuance authority, they are prohibited from receiving notes/bonds/loans proceeds directly. The borrowed money must come into the primary government, and then the primary government can make a contribution to the component unit of schools. This contribution creates another question of the contribution being the total issuance proceeds less issuance cost, or the total proceeds and then allowing the issuance cost to be capitalized as a cost of the asset. Either accounting procedure of the issuance cost is permissible, along with allowing the cost of the issuance to be expensed in the debt service fund.

Recommended Practice: A county’s debt service policy should address how the issuance cost will be expensed or capitalized –not only for the education capital borrowing, but also for the general capital borrowing.

The following scenario (Figure 7) is of a county that has a General Capital Project Fund and desires to issue debt for a school building project with the issuance cost being capitalized as a part of the asset.

Figure 7

					Debit	Credit
Balance Sheet						
	171	11140		Cash with Trustee	$9,675,000.00	
Expenditures						
	171	91100	605	Underwriter's Discount	$125,000.00	
	171	91100	606	Other Debt Issuance Charges	$200,000.00	
Revenue						
	171	49100		Bond Proceeds		$10,000,000.00
To Record the issuance of $10,000,000 of Bonds for School Projects						
					Debit	**Credit**
Balance Sheet						
	171	11140		Cash with Trustee		$9,675,000.00
Expenditures						
	171	91300	605	Underwriter's Discount		$125,000.00
	171	91300	606	Other Debt Issuance Charges		$200,000.00
	171	91300	316	Contributions	$10,000,000.00	
Balance Sheet						
	177	11140		Cash with Trustee	$9,675,000.00	
Revenue						
	177	44570		Contributions		$10,000,000.00
Expenditures						
	177	91300	605	Underwriter's Discount	$125,000.00	
	177	91300	606	Other Debt Issuance Charges	$200,000.00	
To Record Contributions from 171 General Capital Projects to 177 Education Capital Projects along with the related issuance expense to be capitalized						

This second scenario (figure 8) relates to the issuance of debt for educational purposes, and reflects the debt service cost in the debt service fund and not capitalized.

Figure 8

					Debit	Credit
Balance Sheet						
	171	11140		Cash with Trustee	$9,675,000.00	
Revenue						
	171	49100		Bond Proceeds		$9,675,000.00
To Record the issuance of $10,000,000 of Bonds for School Purposes						
					Debit	**Credit**
Balance Sheet						
	171	11140		Cash with Trustee		$9,675,000.00
Expenditures						
	171	91300	316	Contributions	$9,675,000.00	
Balance Sheet						
	177	11140		Cash with Trustee	$9,675,000.00	
Revenue						
	177	44570		Contributions		$9,675,000.00
Revenue						
	151	49100		Bond Proceeds		$325,000.00
Expenditures						
	151	91300	605	Underwriter's Discount	$125,000.00	
	151	91300	606	Other Debt Issuance Charges	$200,000.00	
To Record Contributions from 171 General Capital Projects to 177 Education Capital Projects along with the related issuance cost being expensed in the Debt Service Fund						

These postings reflect that many options are available to receive and expend funds on capital projects. Other postings also are allowed. One should consult auditors or a CTAS consultant if questions arise on the posting of these proceeds.

Further, the above posting brings out a very important issue that often is overlooked and can cause shortages in the capital project. An asset cost generally is the full cost to put the asset into use. This cost includes the cost of the issuance of the debt. The project budget was originally established at $10 million. However, the first expense was not pertaining to the actual construction of the asset, but rather to the issuance of the indebtedness. The examples above reflect that the project has cash available that is $325,000 less than anticipated for the project.

A debt and/or capital projects policy should address the following: issuance cost; if additional funds should be borrowed for issuance cost; if this cost is included in the capital budget where the expense will be incurred; or if the cost of issuance would be absorbed by the debt service fund as noted in figure 9. Also note that the Debt Service Fund is a budget fund, and the budget should be amended to include any revenue and additional expenses.

Figure 9 reflects the Debt Service Fund paying the cost of the debt issuance.

Figure 9

					Debit	Credit
Balance Sheet						
	171	11140		Cash with Trustee	$10,000,000.00	
Revenue						
	171	49100		Bond Proceeds		$10,000,000.00
To Record the issuance of $10,000,000 of Bonds for School Purposes						
					Debit	**Credit**
Balance Sheet						
	171	11140		Cash with Trustee		$10,000,000.00
Expenditures						
	171	91300	316	Contributions	$10,000,000.00	
Balance Sheet						
	177	11140		Cash with Trustee	$10,000,000.00	
Revenue						
	177	44570		Contributions		$10,000,000.00
Revenue						
	151	11140		Cash with Trustee		$325,000.00
Expenditures						
	151	91300	605	Underwriter’s Discount	$125,000.00	
	151	91300	606	Other Debt Issuance Charges	$200,000.00	
To Record Contributions from 171 General Capital Projects to 177 Education Capital Projects along with the related issuance cost being expensed in the Debt Service Fund						

Further depending on how the funds are borrowed, there could be interest earnings from the idle funds not yet expended and interest expensed during the construction phase. For example, the above $9.67 million could earn interest until used. These interest earnings would accrue to the Debt Service Fund and could be used to recoup the issuance cost and defray the interest cost of borrowed monies during construction. The earned interest is not eligible to accrue to the capital project fund.

Recommended Practice: Make sure all parties understand where the cost of the debt issuance will be charged and any interest earning deposited. Reflect this cost and revenues estimates in a budget.

While we are on the subject of cash availability, your debt policy should also address, either on a case by case basis or specifically state in the debt resolution, what will be the disposition of any unused funds after a project is complete. Generally the borrowing instruments state the proceeds shall be for capital outlay, thus allowing the county to use the proceeds for the project approved and any future approved project. Outside the broad language, the remaining funds are transferred back to the Debt Service Fund for the repayment of debt.

Recommended Practice: Allow all excess funds to be available for other capital projects upon specific approval.

Recommended Practice: If a permanent Capital Project Fund has not been established, then a county should take the opportunity to establish a Capital Project Fund with any excess cash.

Posting a Budget for Borrowed Funds and Annual Appropriations

Reference Number: CTAS-1763

The comptroller's office accepts the bond or note approval by the county commission as authorization to establish an appropriations budget. It is highly recommended that an official budget be established reflecting the receiving of the borrowed funds along with the expenditure budget. This receipt and expenditure budget would be in either a Capital Project Fund or an Operating Budget. Figure 10 reflects a sample budget being established for the receipts and expenditures of a Highway Capital Project Fund. The annual expenditures of interest and principal are required to be annually appropriated. This appropriation should be reflected in the appropriations resolution and broken down by the respective classification in which the funds were borrowed. Figure 11 reflects an excerpt from an appropriation resolution.

Recommended Practice: An official capital budget should be established and filed with the county legislative body before or after the issuance of debt.

Recommended Practice: A budget amendment may be needed if new indebtedness causes the payment of interest and/or principal in the year of issuance.

			Current Budget	Amendment	Amended Budget
Highway Capital Projects (176)					
Fund Balance and Designations					
176	39000	Undesignated Fnd Balance	0	0	0
Revenues and Transfers In					
176	44570	Contributions	0	2,500,000	2,500,000
		Total Revenue	0	2,500,000	2,500,000
Expenditures					
	Highway & Street Capital Projects				
176	91200	399 Other Contracted Service	0	1,250,000	1,250,000
	91200	404 Asphalt- Hot Mix	0	250,000	250,000
	91200	405 Asphalt- Liquid	0	215,000	215,000
	91200	409 Crushed Stone	0	500,000	500,000
	91200	703 Asphalt Plant Equipment	0	0	0
	91200	714 Highway Equipment	0	250,000	250,000
	91200	606 Other Debt Issuance Charge	0	35,000	35,000
		Total Expenditures	0	2,500,000	2,500,000
Fund Balance and Designations					
177	39000	Undesignated Fnd Balance	0	0	0

Figure 10

Excerpted from a part of Section 1 of an appropriation resolution.

SECTION 1. ...

151 GENERAL DEBT SERVICE FUND	
82110 Principal-General Government Debt Service	672,295
82120 Principal-Highway and Street Debt Service	507,061
82130 Principal-School Debt Service	750,000
82210 Interest- General Government-Debt	473,968
82220 Interest- Highway and Street Debt Service	66,039
82230 Interest- School Debt Service	250,000
82310 Other Debt Service	15,000
Total General Debt Service Fund	2,734,363

Figure 11

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