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Governmental Accounting Standards Series

Statement No. 23 of the Governmental Accounting Standards Board

Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities

Governmental Accounting Standards Board
of the Financial Accounting Foundation

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Summary

This Statement establishes standards of accounting and financial reporting for current refundings and advance refundings resulting in defeasance of debt reported by proprietary activities—that is, proprietary funds and other governmental entities that use proprietary fund accounting. Refundings involve the issuance of new debt whose proceeds are used to repay previously issued debt. The proceeds may be used immediately for this purpose (a *current refunding*), or they may be placed with an escrow agent and invested until they are used to pay principal and interest on the old debt at a future time (an *advance refunding*).

For current refundings and advance refundings resulting in defeasance of debt reported by proprietary activities, this Statement requires that the difference between the reacquisition price and the net carrying amount of the old debt be deferred and amortized as a component of interest expense in a systematic and rational manner over the remaining life of the old debt or the life of the new debt, whichever is shorter. On the balance sheet, the deferred amount should be reported as a deduction from or an addition to the new debt liability.

In addition, this Statement makes the disclosures required by paragraphs 11–13 of GASB Statement No. 7, *Advance Refundings Resulting in Defeasance of Debt*, applicable to current refundings reported by proprietary activities.

The provisions of this Statement are effective for financial statements issued for periods beginning after June 15, 1994, with earlier application encouraged. Retroactive application is permitted but not required.

Unless otherwise specified, pronouncements of the GASB apply to financial reports of all state and local governmental entities, including public benefit corporations and authorities, public employee retirement systems, utilities, hospitals and other healthcare providers, and colleges and universities. Paragraph 3 discusses the applicability of this Statement.

Statement No. 23 of the
Governmental Accounting
Standards Board

Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities

December 1993



Governmental Accounting Standards Board
of the Financial Accounting Foundation
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December 1993

INTRODUCTION

1. GASB Statement No. 7, *Advance Refundings Resulting in Defeasance of Debt,* provides guidance on (a) accounting in governmental funds for advance refundings that result in defeasance of debt reported in the general long-term debt account group (GLTDAG) and (b) disclosures about advance refunding transactions of all governmental entities regardless of where the debt is reported. This Statement provides guidance on accounting and financial reporting for current refundings and advance refundings resulting in defeasance of debt reported in proprietary funds and by other governmental entities that use proprietary fund accounting.

2. Paragraph 14 of NCGA Interpretation 9, *Certain Fund Classifications and Balance Sheet Accounts,* provides that the gain or loss from a defeasance accounted for in a proprietary fund type should be determined in accordance with APB Opinion No. 26, *Early Extinguishment of Debt,* and reported in accordance with FASB Statement No. 4, *Reporting Gains and Losses from Extinguishment of Debt,* as amended by FASB Statement No. 64, *Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements.* Paragraph 20 of Opinion 26, as amended, requires the immediate recognition of gain or loss in determining net income in the period of extinguishment. The Board has received a number of inquiries questioning whether application of Opinion 26 to proprietary activities accurately portrays the substance of refundings in the governmental environment. This Statement changes the manner in which current refundings and advance refundings resulting in defeasance of debt should be reported by proprietary activities.

STANDARDS OF GOVERNMENTAL ACCOUNTING AND FINANCIAL REPORTING

Scope and Applicability of This Statement

3. The requirements of this Statement apply to *current refundings* and *advance refundings* resulting in defeasance of debt[1] reported by proprietary activities—that is, proprietary funds and other governmental entities that use proprietary fund accounting, including public benefit corporations and authorities, utilities, and hospitals and other healthcare providers.[2] This Statement supersedes paragraphs 13 and 14 of NCGA Interpretation 9, as amended by GASB Statement 7.

Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities

4. For current refundings and advance refundings resulting in defeasance of debt reported by proprietary activities, the difference between the reacquisition price[3] and the net carrying amount[4] of the old debt should be deferred and amortized as a component of interest expense in a systematic and rational manner over the remaining life of the old debt

[1]Refundings involve the issuance of new debt whose proceeds are used to repay previously issued ("old") debt. The new debt proceeds may be used to repay the old debt immediately (a *current refunding*); or the new debt proceeds may be placed with an escrow agent and invested until they are used to pay principal and interest on the old debt at a future time (an *advance refunding*). As described in paragraphs 3 and 4 of GASB Statement 7, an advance refunding may result in the in-substance defeasance of the old debt provided that certain criteria are met.

[2]Some governmental colleges and universities report their transactions and balances using the "Governmental model" as described in GASB Statement No. 15, *Governmental College and University Accounting and Financial Reporting Models.* This Statement also applies to the proprietary funds of those colleges and universities.

[3]*Reacquisition price* is the amount required to repay previously issued debt in a refunding transaction. In a current refunding, this includes principal of the old debt and any call premium. In an advance refunding, it is the amount placed in escrow that, together with interest earnings, is necessary to pay interest and principal on the old debt and any call premium. Premium or discount and issuance costs pertaining to the new debt are not considered part of the reacquisition price, but instead are separate items related to and amortized over the life of the new debt.

[4]*Net carrying amount* is the amount due at maturity, adjusted for any unamortized premium or discount and issuance costs related to the old debt.

or the life of the new debt, whichever is shorter. On the balance sheet, this deferred amount should be reported as a deduction from or an addition to the new debt liability.[5]

5. For current refundings of prior refundings and for advance refundings of prior refundings resulting in defeasance of debt, the difference that is determined in accordance with paragraph 4, together with any unamortized difference from the prior refundings, should be deferred and amortized over the shorter of the original amortization period remaining from the prior refundings or the life of the latest refunding debt (that is, the new debt).

Refunding Disclosures

6. All advance refunding disclosures required by paragraphs 11–13 of GASB Statement 7 (including cash flows differential and economic gain or loss) also should be made for current refundings reported by proprietary activities. Disclosures about advance refundings should continue to be made as required by Statement 7.

EFFECTIVE DATE AND TRANSITION

7. The provisions of this Statement are effective for financial statements issued for periods beginning after June 15, 1994. Earlier application to refunding transactions occurring in periods for which financial statements have not been issued is encouraged. Retroactive application of this Statement to financial statements that previously have been issued is permitted but not required. Retroactive application may be adopted for one or more proprietary activities of an entity or for all proprietary activities of the entity. If adopted retroactively for individual proprietary activities, this Statement should be applied consistently to all current and advance refundings for which deferred amounts would have remained unamortized in the period the Statement is adopted. If accounting changes to adopt the provisions of this Statement are applied retroactively, the financial statements for all prior periods presented should be restated. If restatement is not practical, the cumulative effect of applying this Statement should be reported as a restatement of beginning retained earnings in the period the Statement is adopted. In the period this

[5]The new debt may be reported "net," with either parenthetical or note disclosure of the deferred amount on refunding; or it may be reported "gross," with both the debt liability and related deferred amount presented in the balance sheet.

Statement is first applied, the financial statements should disclose the nature of any restatement and its effect on net income.

The provisions of this Statement need not be applied to immaterial items.

This Statement was adopted by unanimous vote of the five members of the Governmental Accounting Standards Board:

James F. Antonio, *Chairman*
Martin Ives, *Vice-Chairman*
Robert J. Freeman
Barbara A. Henderson
Edward M. Klasny

Appendix A

BACKGROUND INFORMATION

8. At the time GASB Statement 7 was being considered, some respondents expressed the opinion that the accounting gain or loss required to be recognized by APB Opinion 26, and applicable to advance refundings entered into by proprietary activities, did not reflect the economic substance of the transaction. They asked the Board to reconsider the conclusions reached in that Opinion. The Board decided not to address the issue at that time, but noted that Statement 7 requires consistent disclosures about the economic effect of advance refundings for both governmental and proprietary activities.

9. In recent months, the Board has received additional inquiries, again questioning whether application of Opinion 26 to proprietary activity refundings reflects the substance of these transactions. For example, to take advantage of lower interest rates, an entity may call and currently refund old debt if new debt service requirements, together with any additional cash necessary to complete the refunding, will result in future cash flow savings and an economic benefit when compared with old debt service requirements. The application of Opinion 26 to this transaction, however, results in recognition of an accounting *loss* in the period of refunding, primarily due to the payment of call premiums. Similarly, the reporting of accounting losses on advance refundings often is required, even though these refundings, also completed to take advantage of lower interest rates, frequently result in future cash flow savings and economic gains. Although the Statement 7 disclosures are helpful in describing the economic results of these refunding transactions, many governmental financial statement users are still confused when a refunding transaction results in reporting an accounting loss even though the transaction is financially advantageous to the entity because of the reduction in future debt service requirements. After considering these inquiries, the Board added this project to its technical agenda.

10. In June 1993, the Board issued an Exposure Draft (ED) of a proposed Statement, *Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities.* The Board received sixty-nine comment letters on the ED, a large majority of which supported its provisions. Certain changes have been made to this Statement, however, as a result of respondent recommendations.

Appendix B

BASIS FOR CONCLUSIONS

11. This appendix discusses factors considered significant by Board members in reaching the conclusions in this Statement. It includes discussions of the alternatives considered and the Board's reasons for accepting some and rejecting others. Individual Board members gave greater weight to some factors than to others.

Recognition

12. Prior to the issuance of APB Opinion 26 in 1972, three basic methods were used to account for the difference between the reacquisition price and the net carrying amount of the old debt on refundings: (a) amortization over the remaining life of the old debt, (b) amortization over the life of the new debt, and (c) recognition currently in income. In Opinion 26, the three alternatives were reduced to one—current recognition. One argument supporting that position, as discussed in paragraphs 8 and 9 of that Opinion, was that the market value of the old debt has changed over time because of changes in the market rate of interest, but the changes have not been reported in the accounts. Therefore, the entire difference on refunding should be reported as a gain or loss when the old debt is extinguished because the difference relates to past periods. Theoretically, had future events been foreseen perfectly at the time of issuance of the old debt, the accounting would have been based on the assumption that maturity value of the debt would equal its reacquisition price.

13. Opinion 26, in paragraphs 16 and 17, also noted that the economic considerations leading to a decision to extinguish debt generally are the same, regardless of whether the debt is repaid from existing resources, from new equity securities, or from new debt. Under this view, the essential event is the extinguishment; accordingly, the transaction should be accounted for in the same manner regardless of how extinguishment is accomplished.

14. The Board notes that governmental proprietary activities generally do not extinguish debt before maturity without replacing one debt with another through a refunding. As discussed further in paragraphs 15 and 16, these refundings generally are entered into for the purpose of "locking in" currently available lower interest rates, either at call dates or in

anticipation of call dates contained in the old debt contracts. The Board believes these refundings are, in essence, substitutions of new debt (obtained at a lower interest cost) for old debt. Accordingly, the Board concluded that reporting an accounting "gain" or "loss" in the period the old debt is refunded not only fails to report the purpose of the transaction, but also distorts operating results in the period the debt is refunded and in subsequent periods.

15. When outstanding debt is called and is refunded with new debt in a *current refunding*, the difference between the reacquisition price and the net carrying amount of the old debt generally results from one or more factors, all related to the old debt: call premium, unamortized premium or discount, and unamortized issuance costs. A call premium is essentially a fee paid for the privilege of retiring the old debt before its maturity date generally to take advantage of lower current interest rates; it is one of the factors to be considered in determining whether a net benefit may be achieved by the refunding. For example, the issuer considers whether it is better to continue to pay 8 percent interest on the old debt, or to refund that debt at the current interest rate of 5 percent plus the equivalent of 1 percent in call premium and other costs. From that perspective, the difference that results from the refunding is not a separate "loss" transaction, but rather a reduction of the interest savings to be obtained in the future by substituting the new interest rate for the old. For this reason, the Board concluded that the deferral-and-amortization method required by this Statement more appropriately reports the substance of a current refunding transaction taken as a whole.

16. When outstanding debt is *advance-refunded* resulting in defeasance of debt, significant additional resources often are needed. That is, it frequently is necessary to deposit with an escrow agent an amount that, together with interest earnings on the deposit, will enable the agent to pay debt service on the old debt during the period between the refunding date and the call date. Because interest earned on the deposit is generally less than that required to be paid on the old debt, the amount deposited with the escrow agent is greater than the amount that otherwise would be required to cover only principal on the old debt. Generally, this amount is borrowed and becomes part of the new debt. The Board believes that a portion of the new debt (which enters into the calculation of the reacquisition price and hence the accounting "loss" under Opinion 26) should be viewed in the same way as a call premium—not as a separate "loss" to be recognized at the time of the advance refunding, but rather as a reduction of the interest savings to be achieved in the future. Accordingly, the Board again concluded that from a governmental accounting

perspective, the substance of an advance refunding transaction taken as a whole is more appropriately reported by deferring the difference and amortizing it over future periods.

17. On occasion, advance refundings resulting in defeasance of debt may be undertaken in periods of relatively high interest rates to eliminate unwanted provisions in bond agreements or to improve short-term cash flow. When current interest rates are higher than the rates on the old debt, the amount placed in escrow may be less than the amount needed to pay principal and interest on the old debt to the call date. In these situations, the application of Opinion 26 may require recognition of an immediate accounting "gain" even though the long-term effect of the transaction may be an increase in cash outflows and an economic loss. The Board notes that, when this type of advance refunding transaction is taken as a whole, the difference should be recognized as a reduction of the issuer's future interest expense, not as a "gain" at the time of the refunding.

18. The Board also believes that deferral and amortization of differences on refunding transactions provide accounting that is consistent with the operating environment of many governmental enterprises. For example, a housing development authority is principally a financing entity for which charges to program participants are designed to recover the costs of servicing the debt issued to make housing loans. If future debt service can be reduced by an advance refunding to take advantage of lower interest rates, then future charges to participants may be reduced (or at least held constant). Future charges are based on future financing requirements and, therefore, consider (a) interest on the new debt, (b) principal of the new debt, including the additional debt needed to advance-refund the old debt, and (c) other issuance costs of the advance refunding. That is, future financing requirements are based on annual *total* debt service requirements, not merely on the interest segment. Hence, if additional debt is required in an advance refunding to take advantage of lower interest rates, that additional debt is a part of future costs to be recouped through charges to participants, not part of previous costs.

19. A large majority of respondents to the ED agreed with the Board's conclusion that, in the governmental environment, the substance of a refunding transaction taken as a whole can be reported best by deferring the difference and amortizing it over future periods. Many of those in agreement specifically confirmed the assertion that many users are confused by reporting refunding losses on transactions that are economically advantageous to the issuing entity. On the other hand, several respondents disagreed with the deferral and amortization method, indicating that it would create inconsistencies between

accounting standards used by proprietary activities and their private-sector counterparts and, consequently, would create comparability problems between those two groups of entities. Others stated their belief that the operating and financial environments for proprietary activities are the same as those for similar private-sector entities and that, accordingly, they should apply parallel accounting and reporting practices wherever possible.

20. The Board considered these comments but continues to believe that there are differences between governmental refundings and private-sector extinguishments. The conclusion in Opinion 26 that all extinguishments of debt are fundamentally alike and therefore require the same accounting leads to viewing the old debt extinguishment separately from the new debt issuance when refundings are involved. Although the Board believes that this completed-transaction perspective may be appropriate when extinguishments are achieved by using existing resources or proceeds from the issuance of equity securities, these transactions generally do not occur in government. Rather, most governmental debt extinguishments before maturity depend on and are coincidental with the creation of new debt. The Board continues to believe that it is more appropriate to account for governmental refunding transactions as the substitution of new debt for old debt.

Operating Statement Guidance

21. In the ED, the Board proposed that the deferred amount on refunding be amortized to future periods. No specific guidance was provided, however, as to how the annual amortization should be reported in the operating statement. Several respondents asked the Board to address this point. The Board agreed and has modified paragraph 4 accordingly. The Board believes that whether the deferred amount on refunding is positive or negative, its amortization should be reported as a component of interest expense.

Amortization Period and Method

22. The Board considered whether the deferred amount on refunding should be amortized over the remaining life of the old debt or the life of the new debt. As discussed in paragraphs 6 and 7 of Opinion 26, those who at that time supported amortization over the remaining life of the old debt regarded the difference on refunding as an adjustment of the cost of borrowing that arises from obtaining a new debt arrangement for the unexpired

term of the old one. Therefore, they believed that the cost of money over the remaining life of the old issue should be affected by the difference. Those who favored amortizing the difference over the life of the new debt pointed out that the principal motivation for refunding is to establish a more favorable interest rate over the term of the new issue.

23. Most respondents to the ED agreed with the provision that the deferred amount on refunding should be amortized over the remaining life of the old debt or the life of the new debt, whichever is shorter. Some, however, preferred another amortization period; the most frequently mentioned was "the life of the new debt." They reasoned that because the deferred amount arises from replacing the old debt with new debt, it follows that gains or losses should be amortized over the life of the new debt. Further, when new debt is issued, the old debt is removed from the face of the financial statements and its remaining life is irrelevant.

24. As noted earlier, the Board believes that in the governmental environment refundings are more appropriately reported by considering the accounting effects of the transactions taken as a whole, that is, from the time a refunding is entered into until the new debt is repaid. However, the Board also believes that any extension of the life of the new debt beyond the remaining life of the old debt is essentially a borrowing for a new period of time. Accordingly, the interest cost for that additional period of time should stand on its own. On the other hand, if the life of the new debt is shorter than the remaining life of the old debt, the borrowing transaction should be considered complete on maturity of the new debt, rather than leaving an amount to be amortized to a period when neither debt is reported as a liability. Thus, the Board concluded that the amortization period proposed in the ED is appropriate.

25. Some respondents suggested that the Board also should address the amortization period to be used when a proprietary activity refunds a prior refunding. The Board agreed and, in keeping with its position on original refundings, has provided "the shorter of" guidance in paragraph 5.

26. The Board also concluded that the deferred amount on refunding should be amortized in a systematic and rational manner. One method that accomplishes this is the effective-interest method, which amortizes the deferred amount in such a way as to result in a constant rate of interest when applied to the amount of debt outstanding at the beginning

of any period. In addition, other systematic and rational methods (including straight-line or proportionate-to-stated-interest-requirements) may be used.

27. Again, most ED respondents agreed with this broad systematic and rational provision. Several, however, asked that the Board provide more specific guidance as to what constitutes "systematic and rational." The Board realizes that there is not uniform understanding of this term and, accordingly, that its application will require the use of professional judgment. The Board's intention is to allow preparers sufficient latitude to consistently apply amortization methods that produce reasonable results and are cost beneficial.

Reporting of Deferred Amount

28. The Board considered whether the deferred amount on refunding should be reported on the balance sheet as a deferred expense/deferred revenue, or as a deduction from/addition to the new debt liability. Individual elements of the deferred amount could be viewed as prepaid expenses, notably the call premium in a current refunding and a portion of the new debt in an advance refunding in excess of principal requirements on the old debt. The Board believes, however, that these elements, taken together, have no existence apart from the related debt. Together they are neither assets nor liabilities; like valuation accounts, they are part of the liability to which they pertain. The Board therefore concluded that the entire deferred amount should be reported as a valuation account (a deduction from or an addition to the new debt liability).

29. Most respondents to the ED agreed with reporting the deferred amount on refunding as a valuation account. A few, however, requested clarification as to how the components of the new debt liability should be displayed on the balance sheet. The Board acknowledged the importance of this information and has provided display guidance in a footnote to paragraph 4.

Disclosure

30. The Board considered whether the disclosures about advance refundings required by paragraphs 11–13 of GASB Statement 7 should be extended to current refundings of debt reported by proprietary activities. The Board believes that the difference between the present values of the old and new debt service requirements, adjusted for any cash paid, is

the amount that most fairly reflects the economic substance of refunding transactions. The difference in cash flow requirements also is useful because it provides a rate-making perspective on the increases or decreases in cash payments that will be realized by the issuer over the term of the new debt. The Board therefore concluded that, for current refunding transactions, this information also should be disclosed in notes to the financial statements.

Types of Refundings

31. In the ED, the Board described refundings as issuances of new debt whose proceeds are used to repay previously issued debt. In discussing the types of refundings to which the proposed Statement would apply, the Board indicated that in current refundings the new debt proceeds may be used to repay the old debt immediately, whereas in advance refundings the new debt proceeds are placed with an escrow agent until they are used to pay principal and interest at a future time. A few respondents suggested that it would be more appropriate to distinguish between current and advance refundings by using the 90-day repayment threshold cited in the Internal Revenue Code and the federal arbitrage rebate regulations. The Board considered the suggestion but has chosen to retain the more general description because the requirements of this Statement apply equally to either type of refunding.

Application to Governmental Colleges and Universities

32. In the ED, the Board limited the proposed refunding guidance to governmental colleges and universities using the "Governmental model" as described in GASB Statement No. 15, *Governmental College and University Accounting and Financial Reporting Models.* In so doing, the purpose of the Board was to address constituent concerns pertaining to refundings as expeditiously as possible. A few respondents asked that the Board also include guidance for those governmental colleges and universities that use the AICPA College Guide model. The Board has decided to retain the limited scope, noting that there is no proprietary fund accounting provided for under the AICPA College Guide model.

Effective Date and Transition

33. The requirements of this Statement are effective for financial statements issued for periods beginning after June 15, 1994, with earlier application encouraged. Retroactive application to previously issued financial statements is permitted but not required. Several respondents disagreed with the provision permitting retroactive application. Most of those respondents believed this choice would compromise comparability among governmental entities and consistency within a reporting entity that has multiple proprietary activities. Several questioned the cost-effectiveness given the large number of refundings they have completed. Another believed financial statement users likely would be confused by restatement. The Board considered these comments but continues to believe that retroactive application should be made available to those preparers who choose to apply it. Also, the Board believes that retroactive application only to certain proprietary activities of a financial reporting entity should not be precluded.

Appendix C

ILLUSTRATIONS OF ACCOUNTING FOR REFUNDINGS OF DEBT REPORTED BY PROPRIETARY ACTIVITIES

34. This appendix illustrates both calculation of the deferred amount on refunding and use of the effective-interest method of amortizing the amount over future periods. The facts assumed in these examples are illustrative only and are not intended to modify or limit the requirements of this Statement or to indicate the Board's endorsement of the policies or practices shown. Application of the provisions of this Statement may require reporting other than that illustrated here.

Illustration 1—Current Refunding

This example illustrates a current refunding based on these assumptions:

- On January 1, 1993, the State Housing Authority issued at par $35 million of mortgage revenue bonds for the purpose of refunding $35 million of then-outstanding 1978 mortgage revenue bonds. The 1993 bonds bear an interest rate of 5 percent and will be repaid in level principal amounts, with the final payment due January 1, 2000. The refunded 1978 bonds carried an interest rate of 10 percent and also were due in level principal amounts, with the final payment due January 1, 1998.
- In order to accomplish the refunding, the Authority had to pay a 3 percent call premium ($1.05 million) to holders of the outstanding 1978 bonds. Moneys from the 1978 bond sinking fund of $3.55 million were used for this purpose. The remainder of the 1978 sinking fund ($2.5 million) was transferred to a new sinking fund required for the 1993 bonds. Unamortized 1978 bond issuance costs were $250,000 at the date of the refunding.

As provided by paragraph 4 of this Statement, the deferred amount on refunding is the difference between the reacquisition price (funds required to refund the old debt) and the net carrying amount of the old debt, calculated as follows:

Reacquisition price:		
Old bonds outstanding	$35,000,000	
Call premium on old bonds	1,050,000	
Funds required to refund old bonds		$36,050,000*
Net carrying amount of old bonds:		
Old bonds outstanding	(35,000,000)	
Unamortized old bond issuance costs	250,000	
Net carrying amount		(34,750,000)
Deferred amount on refunding		$ 1,300,000

*Funds available to accomplish the refunding are:

Funds provided for refunding:		
New bonds issued	$35,000,000	
Old bond sinking fund	3,550,000	
Total funds provided		$38,550,000
Use of funds—new bond sinking fund		(2,500,000)
Funds available for refunding		$36,050,000

Paragraph 4 also requires that the deferred amount on refunding be amortized in a systematic and rational manner over the remaining life of the old debt or the life of the new debt, whichever is shorter. In this example, the remaining life of the old debt applies. The following table illustrates amortization of the $1.3 million deferred amount over the five-year remaining life of the old debt. (All amounts have been rounded to thousands.)

Year	New Debt, Beginning of Year	Deferred Amount on Refunding	Net New Debt	Effective Interest[a]	Stated Interest	Amortization of Deferred Amount on Refunding[b]
1993	$35,000	$(1,300)	$33,700	$2,094	$1,750	$ 344
1994	30,000	(956)	29,044	1,805	1,500	305
1995	25,000	(651)	24,349	1,513	1,250	263
1996	20,000	(388)	19,612	1,218	1,000	218
1997	15,000	(170)	14,830	920[c]	750	170[c]
				$7,550	$6,250	$1,300

[a] Effective-interest amounts are derived by multiplying the net new debt amount by the effective-interest rate of 6.213 percent. This is the discount rate that equates the present value of future debt service payments ($35,000 in total principal and $6,250 in interest through 1997) to the initial net new debt amount of $33,700. Debt service payments through 1997 include principal of $25,000; the remaining principal ($10,000), scheduled to be paid in 1998 and 1999, is included as a 1997 payment for purposes of calculating the effective-interest rate.

[b] Amortization of the deferred amount in proportion to stated interest requirements would result in a charge of $364 for 1993 [($1,750 ÷ $6,250) × $1,300]; $312 for 1994; $260 for 1995; $208 for 1996; and $156 for 1997.

[c] Adjusted for rounding.

Illustration 2—Advance Refunding

This example illustrates an advance refunding based on the following assumptions:

- On January 1, 1993, the City Parking Authority refunded and defeased in substance its outstanding 1988 Series revenue bonds of $10 million, carrying an interest rate of 10 percent, with new 1993 Series bonds of $12.5 million, issued at a rate of 5 percent. Both series require level annual debt service payments with final payment due December 31, 2007.
- All issuance costs of the transaction ($351,566) were paid from bond proceeds. The net proceeds of $12,148,434 were used to purchase U.S. government securities yielding 5 percent. These securities were deposited with an escrow agent to provide for (1) debt service on the 1988 debt to the call date of December 31, 1997, and (2) a 2 percent call premium due at that time. Unamortized 1988 bond issuance costs were $250,000 at the date of the refunding.

As provided by paragraph 4 of this Statement, the deferred amount on refunding is the difference between the reacquisition price (funds required to refund the old debt) and the net carrying amount of the old debt, calculated as follows:

Reacquisition price (funds required to be deposited in escrow fund to refund old bonds)	$12,148,434*
Net carrying amount of old bonds	(9,750,000)
Deferred amount on refunding	$ 2,398,434

*Funds available to accomplish the refunding are:

Funds provided from issuance of new bonds	$12,500,000
Funds used for new bond issuance costs	(351,566)
Funds available for refunding	$12,148,434

Paragraph 4 also requires that the deferred amount on refunding be amortized in a systematic and rational manner over the remaining life of the old debt or the life of the new debt, whichever is shorter. In this example, both lives are the same. The following table illustrates amortization of both the deferred amount on refunding ($2,398,434) and the new bond issuance costs ($351,566) over subsequent periods. (All amounts have been rounded to thousands.)

							Amortization[b]	
Year	New Debt, Beginning of Year	Deferred Amount on Refunding	Unamortized Issue Costs	Net New Debt	Effective Interest[a]	Stated Interest	Deferred Amount on Refunding	Unamortized Issue Costs
1993	$12,500	$(2,398)	$(352)	$9,750	$ 870	$ 625	$ 214	$ 31
1994	11,921	(2,184)	(321)	9,416	840	596	213	31
1995	11,313	(1,971)	(290)	9,052	808	566	211	31
1996	10,674	(1,760)	(259)	8,655	773	534	208	31
1997	10,003	(1,552)	(228)	8,223	734	500	204	30
1998	9,299	(1,348)	(198)	7,753	692	465	198	29
1999	8,560	(1,150)	(169)	7,241	646	428	190	28
2000	7,784	(960)	(141)	6,683	597	389	181	27
2001	6,969	(779)	(114)	6,076	542	348	169	25
2002	6,113	(610)	(89)	5,414	483	306	154	23
2003	5,214	(456)	(66)	4,692	419	261	138	20
2004	4,270	(318)	(46)	3,906	348	213	118	17
2005	3,279	(200)	(29)	3,050	272	164	94	14
2006	2,239	(106)	(15)	2,118	189	112	67	10
2007	1,147	(39)	(5)	1,103	101[c]	57	39[c]	5[c]
					$8,314	$5,564	$2,398	$352

[a] Effective-interest amounts are derived by multiplying the net new debt amount by the effective-interest rate (8.925 percent). This is the discount rate that equates the present value of future debt service payments ($12,500 in principal and $5,564 in interest) to the initial net new debt amount of $9,750.

[b] The difference between effective interest and stated interest amounts is amortized proportionately between the deferred amount on refunding (87.2%) and unamortized issue costs (12.8%).

[c] Adjusted for rounding.

Appendix D

CODIFICATION INSTRUCTIONS

35. The sections that follow update the June 30, 1993, *Codification of Governmental Accounting and Financial Reporting Standards* for the effects of this Statement. Only the paragraph number of this Statement is listed if the paragraph will be cited in full in the Codification.

* * *

LONG-TERM LIABILITIES **SECTION 1500**

[Revise paragraph .115, including paragraph heading, as follows:]

Debt Refundings

.115 Accounting and financial reporting of advance refundings that result in legal or in-substance defeasance of GLTDAG debt is discussed in Section D20. That section also discusses accounting and financial reporting for current refundings and advance refundings resulting in defeasance of debt reported in proprietary funds and by governmental entities that use proprietary fund accounting.

* * *

NOTES TO FINANCIAL STATEMENTS **SECTION 2300**

[Revise paragraph .107l as follows:]

.107l Debt refundings. (See Section D20, "Debt Refundings," paragraphs .112 through .116.)

* * *

[Rename and revise the entire Section D20 as follows:]

DEBT REFUNDINGS **SECTION D20**

Sources: GASB Statement 7
GASB Statement 23

Scope of This Section

.101 This section provides guidance on accounting and financial reporting for advance refundings that result in defeasance of debt reported in the general long-term debt account group (GLTDAG). It also provides guidance on accounting and financial reporting for current refundings and advance refundings resulting in defeasance of debt reported by proprietary activities—that is, proprietary funds and other governmental entities that use proprietary fund accounting. [GASBS 7, ¶1 and ¶7; GASBS 23, ¶3]

Introduction

.102 Refundings involve the issuance of new debt whose proceeds are used to repay previously issued ("old") debt. The new debt proceeds may be used to repay the old debt immediately (a *current refunding*); or the new debt proceeds may be placed with an escrow agent and invested until they are used to pay principal and interest on the old debt at a future time (an *advance refunding*). Most advance refundings result in defeasance of debt. 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, as discussed below, 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 balance sheet; only the new debt is reported as a liability. [GASBS 7, ¶3; GASBS 23, fn1]

Circumstances for In-Substance Defeasance

.103 [Insert current Codification paragraph .103.]

Reasons for Refundings

.104–.105 [Insert current Codification paragraphs .104 and .105, deleting the word *advance* throughout.] [GASBS7, ¶5 and ¶6, as amended by GASBS 23, ¶3]

Accounting and Reporting

Governmental Funds

.106–.108 [Insert current Codification paragraphs .108 through .110.]

Proprietary Activities[3]

.109–.110 [GASBS 23, ¶4 and ¶5 and related footnotes]

[3] [Insert current Codification footnote 3.]

Disclosures about Advance Refundings

.111 [Insert current Codification paragraph .111.]

.112 [Insert current Codification paragraph .112. Insert "For disclosure purposes," at the beginning of the first sentence.]

.113–.114 [Insert current Codification paragraphs .113 and .114.]

Disclosures about Current Refundings—Proprietary Activities

.115 All disclosures required by paragraphs .111–.113 for advance refundings should also be made for current refundings reported by proprietary activities. [GASBS 23, ¶6]

NONAUTHORITATIVE DISCUSSION

Illustration of Effective Interest Rate and Economic Gain Calculations

.901–.915 [Insert current Codification paragraphs .901–.915.]

[Insert Examples I through III.]

Illustrative Note Disclosures

.916 [Insert current Codification paragraph .916, revising the last paragraph in Note X, pertaining to proprietary activities, as follows:] The advance refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of $8.1 million. This difference, reported in the accompanying financial statements as a deduction from bonds payable, is being charged to operations through the year 2011 using the effective-interest method. The Agency completed the advance refunding to reduce its total debt service payments over the next 25 years by $6.4 million and to obtain an economic gain (difference between the present values of the old and new debt service payments) of $2.9 million. [GASBS 7, ¶43; GASBS 23, ¶4]

Illustrations of Accounting for Refundings of Debt Reported by Proprietary Activities

.917 [GASBS 23, Appendix C] [Change "appendix" to "paragraph" and "Statement" to "section."]

* * *

COLLEGES AND UNIVERSITIES SECTION Co5

Sources: [Add the following:] GASB Statement 23

.101 [Revise the first sentence as follows:] The requirements of these Codification sections, which are based on GASB pronouncements, apply to all state and local governmental entities, including colleges and universities, unless otherwise specified:

[Add the following to the list and renumber remaining footnotes:]

D20, "Debt Refundings"[2]

[GASBS 2–9, 12–16, and 23; GASBI 1]

[2]Paragraphs .106–.110 and .115 of Section D20 apply to the proprietary funds of those governmental colleges and universities that report their transactions and balances using the Governmental model. [GASBS 23, fn2]

* * *

HOSPITALS AND OTHER HEALTHCARE PROVIDERS SECTION Ho5

Sources: [Add the following:] GASB Statement 23

.103 [Add the following to the list:]

D20, "Debt Refundings"

[GASBS 2–7, 12–14, 16, and 23; GASBI 1]

* * *

PUBLIC BENEFIT CORPORATIONS AND AUTHORITIES SECTION Pu5

Sources: [Add the following:] GASB Statement 23

.101 [Add the following to the list in footnote 1:]

D20, "Debt Refundings"

[GASBS 2–10, 12–14, 16, and 23; GASBI 1]

* * *

Sources: [Add the following:] GASB Statement 23

.102 [Add the following to the list:]

D20, "Debt Refundings"

[GASBS 2–7, 9, 12–14, 16, and 23; GASBI 1]