

PLANT ACCOUNTING: BOND FINANCING

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PLANT ACCOUNTING: BOND FINANCING

"Three things are to be looked to in a building: that it stand on the right spot; that it be securely founded; that it be successfully executed."

--Johann Wolfgang Von Goethe

I. INTRODUCTION

The University issues multiple purpose project bonds and project or campus specific bonds. Bond issues are used to finance the construction, renovation, and acquisition of housing, parking, student unions, recreation centers, research, medical, and administrative facilities. This chapter sets forth the general accounting procedures for recording bond-funded projects. The chapter deals primarily with multiple purpose project bonds. The trustee accounts and bond liability for multiple purpose project bonds are recorded at the Office of the President (OP). The accounting for project (or campus) specific bonds is performed by the campus accounting office.

When a bond issue is authorized to finance a project, the Treasurer's Office may arrange for interim construction financing. Under this arrangement, the campus requests funds monthly to cover anticipated construction expenditures during the interim period, pending the actual sale of the bonds. These temporary financing expenditures are accounted for as outlined in Accounting Manual chapter P-415-12, Plant Accounting: Borrowed Funds--Local.

II. DEFINITIONS

The definitions of key words and terms used in this chapter are presented below. However, these are general definitions; when dealing with a specific bond, refer to the definitions within the bond indenture.

Aggregate Debt Service is the total of principal and interest payments due in a specified number of time periods.

Amortization is the process of gradually paying off the

principal amount of an issue by making periodic payments either directly to bondholders or to a sinking fund. Amortization payments are calculated to include both interest and principal due.

Arbitrage occurs when invested borrowed funds yield a return greater than the cost of borrowing.

Bond Year is the twelve month period defined in the indenture, e.g., from November 1 to October 31.

Debt Service is the total principal and/or interest payment owed to the trustee or bond holders.

Defeas is to eliminate an outstanding bond issue legally by placing sufficient funds in escrow to guarantee punctual payment of principal and interest.

Gross Revenues include all income derived from the ownership or operation of a project. Without limiting the scope of this definition, income includes rents, rates, fees, charges, insurance proceeds, and other monies derived by The Regents from such ownership or operation, but excludes any refundable deposits or fines and forfeitures.

Indenture is the document that outlines the terms and conditions governing a bond issue sold to external sources, the proceeds of which are used to construct or refinance various income producing facilities.

Mandatory Sinking Account Payment is the amount required by the indenture to be paid by The Regents to the trustee, on any given date, for the retirement of a bond issue.

Maximum Aggregate Annual Debt Service is the total annual debt service amount due for the bond year in which the aggregate of such debt service payments is the largest.

Net Revenues are pledged revenues remaining after deduction for or payment of operation and maintenance expenses.

Official Statement is a comprehensive statement containing information concerning the security being offered and the issuer of that security. Full disclosure of all

II. DEFINITIONS (Cont.)

pertinent information is required in this document. The official statement is similar to a prospectus. A preliminary official statement is often available prior to the final official statement, which typically is printed only when the final pricing and terms of the security issue have been determined.

Revenue Bond is a bond for which the interest and principal payments are funded solely by the revenue generated from the operation of the related financed facilities financed with the bond proceeds.

Sinking Fund is a separate fund created to receive periodic deposits from the issuer for the purpose of assuring the availability of cash for the retirement of bonds at maturity. Such a fund is ordinarily established with an independent trustee, in accordance with the terms of the indenture.

Trustee is a bank or trust company designated by the indenture as the custodian of funds who acts in a fiduciary capacity as the official representative of the bondholder(s) and issuer(s).

III. INDENTURED PROJECTS

The Treasurer's Office, with the assistance of University's external bond counsel, the General Counsel's Office, and the Office of the Associate Vice President--Business and Finance, is responsible for negotiating revenue bond sales. A preliminary official statement, which outlines the details of the bond issue, often is available prior to the final statement prepared for the prospective bond buyers. After the bonds have been sold and the funds received, any interim construction financing is paid off and a permanent financing scheme is set in place. Bond proceeds are distributed as outlined in the bond indenture. The terms of the bond indenture govern all aspects of the project and its revenues.

The bond proceeds may be distributed to the trustee in the following types of trust accounts:

Prepaid Interest Account
Capitalized Interest Account

Construction Account
Cost of Issuance Account
Bond Reserve Account

If a Prepaid Interest Account is established, any interest income prepaid by the bond holders at the time of the bond sale is deposited in this account to fund part of the first interest payment to the bond holders.

Funds deposited in the Capitalized Interest Account are used solely for the purpose of funding the bond interest during the construction period.

Funds deposited in the Construction Account are used for the construction, renovation, and acquisition of the projects funded by the indenture. The University requests reimbursement for these costs from the trustee.

Funds deposited in the Cost of Issuance Account are used to pay costs associated with the sale of the bonds, including bond counsel fees.

Funds deposited in the Bond Reserve Account are used to make up any debt service deficiency, if required. If the funds are not used during the life of the indenture, they are either used to fund the final debt service or to reimburse The Regents after the final payment is made.

In accordance with the bond indenture, other trustee accounts may be established, e.g., separate interest and principal trust accounts. In addition, the indenture may indicate the procedures to follow in disbursing any unused monies in these trustee accounts.

The Corporate Accounting Office (CAO) in OP distributes to campuses specific accounting procedures and amortization schedules for each bond sale. Sections IV., V., and VI. below detail general accounting procedures for bond-financed projects.

IV. MULTIPLE PURPOSE PROJECT BONDS

All trustee cash accounts are recorded at OP by the CAO. With the exception of the Bond Reserve Account, which is recorded in the Retirement of Indebtedness fund group, all bond proceed accounts are recorded in the Unexpended Plant

IV. MULTIPLE PURPOSE PROJECT BONDS (Cont.)

fund group during the construction period. During the post construction period, trustee cash accounts are recorded in the Retirement of Indebtedness fund group.

A. CONSTRUCTION PERIOD

Initial Entries

To record the bond proceeds for construction, cost of issuance, capitalized interest, and prepaid interest or premium account, the following entry is prepared by OP:

| | |
|------------------------------|---------------------|
| Dr. Trust Accounts | J-1000XX-01XXX |
| Cr. Fund Balance | J-101XXX-01XXX-1500 |
| Cr. Prepaid Interest/Premium | J-100XXX-01XXX |

The CAO records the Bond Reserve account and the offsetting liability in Retirement of Indebtedness as follows:

| | |
|------------------------|----------------|
| Dr. ROI Trust Account | J-1016XX-017XX |
| Cr. ROI Bond Liability | J-10169X-017XX |

The balance of the liability is recorded in Investment in Plant as follows:

| | |
|------------------------------|----------------|
| Dr. Investment In Plant Fund | J-101999-01990 |
| Cr. Revenue Bond Liability | J-10194X-01990 |

Request for Funds

Since funds for construction expenditures are held by the trustee in the Construction Account, campuses must submit a monthly request to the CAO for the reimbursement of project expenditures. Such requests are forwarded by the CAO to the Treasurer's Office, which prepares a formal letter to request the funds from the trustee. Schedule A contains a sample Monthly Drawdown Request form.

The funds will be credited to the campus as follows:

| | |
|------------------------------|----------|
| Dr. General Cash | J-110000 |
| Cr. Campus Financial Control | J-1195X0 |

A copy of the Treasurer's Report reflecting the credit will be provided to the campus. However, the following entry must be prepared by the campus at the time the request for reimbursement is made, in order to limit campus Short Term Investment Pool (STIP) expense:

| | |
|--------------------------|---------------------|
| Dr. OP Financial Control | X-119500 |
| Cr. Fund Balance | X-101XXX-01XXX-5000 |

If bond proceeds are used to pay off an interim loan, the campus must prepare the following entry to reverse the original fund balance and transaction code:

| | |
|-------------------------------|---------------------|
| Dr. Interim Loan Fund Balance | X-101XXX-01XXX-1550 |
| Cr. Fund Balance | X-101XXX-01XXX-5000 |

At month end, when reconciling the trustee statement, the CAO responds to the two previous entries as follows:

| | |
|--------------------|---------------------|
| Dr. Fund Balance | J-101XXX-01XXX-5000 |
| Cr. Trust Accounts | J-1000XX-01XXX |

Interest Income and Capitalized Interest

When debt service payments are made from the Capitalized Interest account, the CAO prepares the following entry to record the decrease in the trust balance and the transfer of funds to the campus:

| | |
|-------------------|---------------------|
| Dr. Fund Balance | J-101XXX-01XXX-5000 |
| Cr. Trust Account | J-1000XX-01XXX |

The campus prepares the following entries to charge the project account and credit the fund balance account:

| | |
|--------------------------|---------------------|
| Dr. Project expenditures | X-9XXXXXX-01XXX |
| Cr. Fund Balance | X-101XXX-01XXX-5000 |

The CAO prepares the following entry each month to record investment income earned in the trustee accounts:

| | |
|--------------------|---------------------|
| Dr. Trust Accounts | J-1000XX-01XXX |
| Cr. Fund Balance | J-101XXX-01XXX-1300 |

IV. MULTIPLE PURPOSE PROJECT BONDS (Cont.)

B. POST CONSTRUCTION PERIOD

When a project is completed, the CAO transfers the trustee balances from Unexpended Plant Funds to Retirement of Indebtedness Funds. In accordance with the terms of the indenture, surplus funds are used for debt service payments.

When the Capitalized Interest account is exhausted, the debt service must be funded by the campus. The campus financial control account is charged as follows:

| | |
|------------------------------|----------|
| Dr. Campus Financial Control | J-1195X0 |
| Cr. General Cash | J-110000 |

The campus must prepare the following entries to transfer funds for principal (P) and interest (I):

| | |
|--------------------------|---------------------|
| Dr. ROI Fund Balance (P) | X-1017XX-017XX-2195 |
| Dr. ROI Fund Balance (I) | X-1017XX-017XX-2295 |
| Cr. OP Financial Control | X-119500 |

Funds must be transferred by the campus to the Retirement of Indebtedness fund group to fund these expenditures.

The CAO prepares the following entries to reflect the transfer of funds for principal (P) and interest (I) and the actual principal (P) and interest (I) payments, as follows:

| | |
|--------------------------|---------------------|
| Dr. ROI Fund Balance (P) | J-1017XX-017XX-21X5 |
| Dr. ROI Fund Balance (I) | J-1017XX-017XX-22X5 |
| Cr. ROI Fund Balance (P) | J-1017XX-017XX-2195 |
| Cr. ROI Fund Balance (I) | J-1017XX-017XX-2295 |

V. PROJECT OR CAMPUS SPECIFIC BONDS

Following are some of the accounting entries required to record the transactions involved in the sale and redemption of bonds for a campus specific bond sale. These entries are basically the same as for multiple purpose project bonds. Examples of these bonds are housing, parking, student unions, recreation centers, and medical center bonds.

A. CONSTRUCTION PERIOD

The receipt of funds from the sale of the bonds is recorded in Unexpended Plant Funds as follows:

| | |
|--------------------------------|---------------------|
| Dr. OP Financial Control | X-119500 |
| Cr. Revenue Bonds Fund Balance | X-101XXX-01XXX-1500 |

To reimburse the bank(s) for the amount of interim financing received prior to the sale of the bonds:

| | |
|--------------------------|---------------------|
| Dr. Campus Fund Balance | X-101XXX-01XXX-1550 |
| Cr. OP Financial Control | X-1195X0 |

B. POST CONSTRUCTION PERIOD

To transfer net revenues from current operations to the Net Revenue Fund in Retirement of Indebtedness funds:

| | |
|------------------------|-----------------------|
| Dr. Unexpended Balance | X-119850-70XXX-0-0542 |
| Cr. Net Revenue Fund | X-1017XX-017XX-0-3032 |

Debt service transferred from the campus net revenue fund in the Retirement of Indebtedness fund group to the trustee is recorded as follows:

| | |
|--------------------------|-----------------------|
| Dr. Net Revenue Fund | X-1017XX-017XX-0-4100 |
| Cr. Trustee Held Funds | X-1017XX-017XX-0-4100 |
| Dr. Cash Held by Trustee | X-101610-017XX-0 |
| Cr. Cash | X-11XXXX |

Both entries must be made at the same time to ensure that the amount of the assets held by the trustee is the same as the trustee fund balance at the end of each month.

As an alternative, the two preceding entries can be combined by making the following entries to fund the funds held by the trustee:

| | |
|--------------------------|-----------------------|
| Dr. Unexpended Balance | X-119850-70XXX-0-0542 |
| Cr. Trustee Held Funds | X-1017XX-017XX-0-3032 |
| Dr. Cash Held by Trustee | X-101610-017XX-0 |
| Cr. Cash | X-11XXXX |

V. PROJECT OR CAMPUS SPECIFIC BONDS (Cont.)
B. POST CONSTRUCTION PERIOD (Cont.)

** Monthly, the campus Accounting Office will make the following entry in the trustee accounts to record investment income earned as follows:

| | |
|--------------------------|-----------------|
| Dr. Trust Accounts | J-1000XX-01XXX |
| Cr. Project Expenditures | X-9XXXXXX-01XXX |

To record the payment of trustee fees and other authorized costs from the Net Revenue Fund when approved by the Treasurer's Office:

| | |
|---------------------------------|-----------------------|
| Dr. Net Revenue Fund | X-1017XX-017XX-0-2998 |
| Cr. Cash (or Financial Control) | X-11XXXX |

Some indentures may require payments from operating income or from funds held by the trustee.

To record interest earned by the trustee on investments per the trustee statement:

| | |
|----------------------------|-----------------------|
| Dr. Assets Held by Trustee | X-1016XX-017XX |
| Cr. Net Revenue Fund | X-1017XX-017XX-0-1305 |

At fiscal year-end, the cash and investments should be identified in separate accounts for reporting purposes. The trustee summary statement at the end of each report may be referenced to determine the amount to be allocated to cash and to investments. If the amount of cash held by the trustee is over \$100,000, the campus should make a reversing type 14 journal entry to a trustee cash account X-10160X as follows:

| | |
|----------------------------|----------------|
| Dr. Trustee Cash | X-10160X-017XX |
| Cr. Assets Held by Trustee | X-1016XX-017XX |

To record payments made by the trustee for principal (P) and interest (I) on campus revenue bonds:

| | |
|----------------------------|-----------------------|
| Dr. Bond Sinking Fund (P) | X-1017XX-017XX-0-21X5 |
| Dr. Bond Sinking Fund (I) | X-1017XX-017XX-0-22X5 |
| Cr. Assets Held by Trustee | X-1016XX-017XX |

To reduce Bond Liability and increase Investment in Plant equity by the payment of principal to the bond holders:

| | |
|------------------------------|----------------|
| Dr. Revenue Bonds Liability | X-1019XX |
| Cr. Investment in Plant Fund | X-101999-01990 |

VI. BOND REFINANCING

The Regents occasionally issue bonds for the purpose of refinancing existing bond debt. The University will establish an escrow account from the bond proceeds, to advance refund and defease part or all of the bonds financing an existing program. For accounting purposes, this is considered an in-substance defeasance and, therefore, the refunded bond debt and the escrow trust assets used to fund it are not reflected in the University's annual report. However, the party responsible for the bond is required to track the escrow account and the defeased (refunded) liability until it is paid off.

A. RETIREMENT OF INDEBTEDNESS

The campus or the CAO must track the irrevocable escrow trust account for the defeased portion of the liability either in the general ledger or in a separate record. They can record the irrevocable escrow trust account, the defeased portion of the liability and the fund balance in the Retirement of Indebtedness funds account as follows, using transaction code 2990 "Debt Extinguishment":

| | |
|--------------------------------|-----------------------|
| Dr. Defeased Trust Account | X-1016XX-0XXXX |
| Cr. Defeased Liability Account | X-1016XX-0XXXX |
| Cr. Defeased Fund Balance | X-1017XX-XXXXX-0-2990 |

However, at fiscal year-end the campus or the CAO must zero out the trust asset account, the liability, and the fund balance.

B. INVESTMENT IN PLANT

The campus or the CAO also must record any increase (or decrease) in bond debt. Since this is the result of debt extinguishment, it should be recorded directly to Investment In Plant as follows:

| | |
|------------------------------|----------------|
| Dr. Investment In Plant Fund | X-101999-01990 |
| Cr. Revenue Bond Liability | X-1019XX |

VII. INDENTURE CHECKLIST

Since it is essential that the University continue to maintain the highest possible bond ratings, the terms and conditions of each bond indenture must be met in a timely manner.

The CAO and the campuses should design a checklist based on the indentures to ensure that all requirements are met in a timely manner, i.e., that all required transfers are made; all trustee statements are received, recorded, and reconciled on a regular basis; and the required fund balances are maintained. The checklist also should include all items required by the indenture. Schedule B contains a sample checklist.

VIII. RESPONSIBILITIES

For multiple purpose project bonds, it is the responsibility of the Associate Vice President--Business and Finance to ensure that the terms and conditions of the bond are accounted for accurately and to prepare the annual bond audit report. For project specific bonds, it is the responsibility of the accounting officer to ensure that the terms and conditions of campus bonds are accounted for accurately and to prepare the annual bond audit report.

IX. REFERENCES

Accounting Manual Chapters:

| | | |
|----------|-------------------|-------------------------------|
| P-415-3 | Plant Accounting: | Investment in Plant |
| P-415-5 | Plant Accounting: | Retirement of Indebtedness |
| P-415-8 | Plant Accounting: | Unexpended Plant Funds |
| P-415-12 | Plant Accounting: | Borrowed Funds--Local |
| P-415-16 | Plant Accounting: | Certificates of Participation |

Historical note: Original Accounting Manual chapter first published 12/1/86. Revisions 6/1/88, 7/1/91, 6/30/96, and 3/31/97; analyst--Ken Strangfeld.

SCHEDULE A

MONTHLY DRAWN DOWN REQUEST

Name of Campus: _____

Name of Project: _____

Total Capitalized to Date: \$ _____

Total per current general ledger: \$ _____

Estimate for current month: \$ _____

Total Expenditures: \$ _____

Less Total Received to Date: \$ _____

Amount Requested: \$ _____

Requestor _____

Date _____

Schedule B

| <u>MONTHLY CHECKLIST</u> | | |
|--------------------------|----|--|
| | 1) | Respond to the trustee statements by adjusting the general ledger balances, based on activity recorded by the trustee. |
| | | |
| | 2) | Reconcile the general ledger to the trustee statement. |
| | | |
| | 3) | Make required transfers to the trustee. |
| | | |
| | 4) | Request reimbursement of construction expenditures, if required. |

| <u>SEMI-ANNUAL CHECKLIST</u> | | |
|------------------------------|----|--|
| | 1) | Make debt service payment to trustee. |
| | | |
| | 2) | Review revenue bond indentures to determine the appropriate balances and the flow of funds prior to year end, and the amount of surplus funds held by the trustee, if any. |