



NORTH CAROLINA
DEPARTMENT OF STATE TREASURER
STATE AND LOCAL GOVERNMENT FINANCE DIVISION
AND THE LOCAL GOVERNMENT COMMISSION

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Memorandum #2010-36

TO: Officials of Local Governments and Public Authorities and Their Independent Auditors

FROM: Sharon Edmundson, Director Fiscal Management Section

SUBJECT: Accounting for Recovery Zone Economic Development Bonds (Direct Payment)

DATE: May 25, 2010

Section 1401 of American Recovery and Reinvestment Act (ARRA) authorized state and local governments to issue Recovery Zone Economic Development Bonds (Direct Payment) (RZEDB) which have a refundable credit subsidy equal to 45 percent of the total coupon interest payable to investors. The following memo provides guidance for **units that have issued these types of bonds** on how and when to apply for the federal subsidy as well as related accounting entries.

A unit of government must report issuance of the bonds on IRS Form 8038-G, Information Return for Tax-Exempt Governmental Obligations. The Form 8038-G with respect to an issue must be filed with the IRS at least 30 days before the first Form 8038-CP is filed to request payment with respect to an interest payment date. Units should have filed this form under guidance of bond counsel at time of closing.

The filing procedures for issuers to receive their subsidies are quarterly reimbursements for variable rate debt and on a contemporaneous basis for fixed rate debt. The federal government stated that issuers should expect to receive requested payments within 45 days of the date that a processible Form 8038-CP is filed with the IRS.

Fixed Rate Bonds

Issuers of Fixed rate Recovery Zone Economic Development bonds (direct payment) should file IRS Form 8038-CP by the 45th day **before** the applicable interest payment date of the RZEDB bonds. The form may not be filed earlier than the 90th day before the applicable interest payment date.

Variable Rate Bonds

The issuer of variable rate RZEDB bonds will file the 8038-CP on a quarterly basis. The due date for Form 8038-CP for variable rate bonds is the 45th day **after** the last interest payment date within the quarterly period for which reimbursement is requested.

Upon receipt of a timely filed Form 8038-CP requesting payment of the credit, the IRS will reimburse quarterly based on interest paid by the issuer during the quarter.

Accounting

Early on there questions regarding reporting of the federal subsidy - should it be reported as a revenue or a reduction of an expenditure? Since this issue is a national issue, we contacted GASB for their input. GASB is advising that the federal subsidy be reported as revenue under GASB 33 guidance for non-exchange transactions.

Governmental Fund Journal Entries

	<u>Debit</u>	<u>Credit</u>
1 Bond Interest Expenditure	\$100,000	
Cash		\$100,000
<i>Record semi-annual interest payment</i>		
2 Interest Receivable	45,000	
Federal Bond Interest Subsidy-revenue		45,000
<i>Record Federal Subsidy</i>		
3 Cash	45,000	
Interest Receivable		45,000
<i>Record receipt of federal subsidy</i>		

The notes should disclose the details of the borrowing and subsidy including the net interest cost.

Proprietary Fund Journal Entries

Proprietary funds use the economic resources measurement focus basis of accounting. This means most governmental units record accrued interest expense as of June 30 on the Net Asset Statement. A proportional amount of the subsidy should also be accrued as a current year receivable.

	<u>Debit</u>	<u>Credit</u>
1 Bond Interest Expense	\$100,000	
Cash		\$100,000
<i>Record semi-annual interest payment(during fiscal year)</i>		
2 Interest Receivable	45,000	
Federal Bond Interest Subsidy		45,000
<i>Record Federal Subsidy(during fiscal year)</i>		
3 Cash	45,000	
Interest Receivable		45,000
<i>Record receipt of federal subsidy during year</i>		
4 Interest Receivable	14,850	
Federal Bond Interest Subsidy		14,850
Bond Interest Expense	33,000	
Interest Payable		33,000
<i>To Accrue Year-end interest and subsidy</i>		

Government-wide Journal Entries

If the bonds are accounted for in a governmental fund (as opposed to an enterprise fund), at year-end the governmental unit will have to make entries to convert the accounting from the current financial resources basis of accounting to the economic resources measurement focus basis of accounting for government-wide statement presentation. Entries similar to Proprietary Fund journal entry number four above would be used to accrue both subsidy revenue and interest expense.

Sample Elements of Debt Note:

Original issue of \$2,857,145, Recovery Zone Economic Development bonds (Direct Payment) due on July 1 and January 1 in 38 installments of \$150,000 through July 1, 2029; plus interest at 7 percent. The County receives a subsidy of 45 percent of interest cost from the Federal Government reducing the effective interest rate to 3.15 percent.

Should you have questions or need assistance, please contact Melinda Canady at (919) 807-2384 or via email at melinda.canady@nctreasurer.com.