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RETRO GASB WEBINAR SERIES

Revisiting the Standards That Shaped Government Financial Reporting

WEDNESDAY

SEPTEMBER 2

10:00 AM PST

GASB 7 + 23

PAST GUIDANCE.
Learn from where it all started.

PRESENT IMPACT.
See how legacy standards still shape today.

EARN 1 CPE CREDIT!

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Your Presenter

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Manager, Assurance & Advisory

Retro GASB Series

The **Retro GASB Series** takes a step back to connect the dots. We'll revisit key legacy standards that continue to influence today's reporting requirements, break down how they've evolved over time, and explain how those changes are showing up in current and upcoming guidance.

Advance refundings and proprietary refundings are unique to governmental accounting. Today we'll discuss the basis and reasons for GASB's implementation of these concepts.

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GASB 7 & 23

More than financing moves — refundings reshape liabilities, interest expense, debt service trends, and disclosure transparency.

- GASB 7 created a governmental fund reporting model and a disclosure framework for advance refundings that result in defeasance.
- GASB 23 extended to proprietary activities and moved away from immediate gain/loss recognition toward deferral and amortization.

Retro lens: Where we were → What changed → Why it still matters

Debt Refunding Timeline

1987
GASB 7
Advance refundings resulting in defeasance

1993
GASB 23
Refundings by proprietary activities

2012
GASB 65
Deferred outflow/inflow presentation for refunding differences

2018
GASB 88
Expanded debt disclosures, including direct borrowings and placements

POLLING QUESTION #1

Which item best describes an advance refunding?

A. Old debt is repaid immediately using existing cash only
B. New debt proceeds are placed with an escrow agent until future payment of old debt
C. Debt is modified without issuing new debt
D. A compensated absence liability is removed from the statements

Key Terms

Term	Definition	Why it matters
Refunding	New debt is used to repay old debt.	Sets up the accounting question: replace, defer, disclose, or recognize?
Current refunding	Old debt is repaid immediately.	GASB 23 applies to proprietary activities.
Advance refunding	Proceeds are held in escrow until old debt payments occur later.	May produce legal or in-substance defeasance.
Defeasance	Old debt is no longer reported as a liability.	Requires accurate note disclosure for debt still outstanding.
Economic gain/loss	PV comparison of old and new debt service, adjusted for cash paid.	Shows the economic substance behind the financing decision.

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GASB 7

Original issue: Many governments advance refunded debt in 1985 and 1986 to take advantage of favorable municipal bond conditions.

- Existing guidance did not fully address governmental fund accounting for payments made to escrow agents.
- Practice varied: some reported gains/losses; others recorded the payment as an expenditure or other financing use.
- GASB 7 introduced a more consistent governmental fund model and required disclosures focused on economic effect.

GASB 7 Scope and Applicability

Requirement area	Applies to	Practical implication
Accounting model	Advance refundings of debt reported in the general long-term debt account group.	Governmental funds recognize flows, not long-term debt changes within fund statements.
Disclosure model	Advance refunding transactions of all governmental entities, regardless of where the debt is reported.	Debt footnotes should explain cash flow differential and economic gain/loss.
Effective date	Fiscal years beginning after December 15, 1986.	Older standard, but its disclosure concepts remain part of debt refunding history.

When does in-substance defeasance occur?

Irrevocable escrow/trust	Used solely for old debt service	Future payments by issuer are remote	Escrow assets are essentially risk-free	Cash flows align with old debt

- The trust must be restricted to monetary assets that are essentially risk-free as to amount, timing, and collection.
- For U.S. dollar debt, GASB 7 limits qualifying assets to direct U.S. government obligations, obligations guaranteed by the U.S. government, and certain securities backed by U.S. government obligations.
- Callable securities may create timing risk and may not qualify for defeasance purposes.

GASB 7 Accounting Model: Governmental Funds

Transaction component	Classification under GASB 7	What to watch
New refunding bonds issued	Other financing source: proceeds of refunding bonds	Make sure proceeds are not buried in revenue.
Payment to escrow agent from new debt proceeds	Other financing use: payment to refunded bond escrow agent	Separate from debt service expenditures to preserve trend clarity.
Payment to escrow agent from other entity resources	Debt service expenditure	Current resources used to meet/reduce debt obligations.
Change in long-term debt amount	Adjust general long-term debt account group	Today, translate conceptually to government-wide long-term liabilities.

GASB 7 Disclosures

- General description of the advance refunding transaction in the year of refunding.
- Difference between old debt service cash flows and new debt service cash flows, including cash needed to complete the refunding.
- Economic gain or loss, calculated as the present value difference using the effective interest rate of the new debt.
- Subsequent periods: disclose the amount of in-substance defeased debt still outstanding at period-end.

Audit mindset: Does the note explain both the budgetary cash flow impact and the time-value-of-money impact?

Cash Flow Savings vs. Economic Gain

Measure	Question answered	Calculation emphasis
Cash flow difference	Will total future cash payments increase or decrease?	Compares total old debt service with new debt service and cash used to complete the refunding.
Economic gain/loss	What is the present value benefit or cost?	Discounts old and new debt service at the effective interest rate of the new debt and adjusts for cash paid.
Effective interest rate	What rate captures issuer cost of the new debt?	Uses new debt service requirements and proceeds adjusted for recoverable/nonrecoverable issuance costs.

Subsequent-period Disclosures

- When in-substance defeased debt remains outstanding, GASB 7 requires disclosure of the amount still outstanding at period-end.
- The Board concluded disclosure is needed because the entity remains, in effect, the guarantor of the debt even if future payment is remote.
- Common pitfall: carrying forward an old note line without reconciling it to the trustee/escrow records or the prior-year disclosure.

GASB 7: Lessons Learned

Incomplete escrow documentation

Confusion between legal and in-substance defeasance

Cash flow savings disclosed without economic gain/loss

Inconsistent treatment of issuance costs

Prior-year defeased debt not rolled forward

POLLING QUESTION #2

Under GASB 7, payments to the escrow agent from new refunding bond proceeds are reported as:

A. Debt service expenditures
B. Other financing uses
C. Program revenue
D. Capital outlay

GASB 23

- GASB 7 addressed governmental fund accounting and created consistent advance refunding disclosures.
- Questions remained for proprietary activities because immediate gain/loss recognition could make economically advantageous refundings look like operating losses.
- GASB 23 reframed refundings in the governmental environment as substitutions of new debt for old debt, with the difference deferred and amortized over future periods.

> Key shift: from immediate hit to income → deferred amount tied to the new debt liability and amortized through interest expense

GASB 23 Scope

Applies to	Includes	Does not replace
Proprietary activities	Proprietary funds and other governmental entities that use proprietary fund accounting.	GASB 7 governmental fund accounting model.
Current refundings	New proceeds used to repay old debt immediately.	Debt note disclosure principles still apply.
Advance refundings resulting in defeasance	New proceeds placed with escrow agent and invested until used to pay old debt.	Defeasance analysis and disclosure obligations.

GASB 23 Core Accounting Model

Reacquisition price	minus net carrying amount of old debt	= deferred amount on refunding	amortize through interest expense

Key Terms

Term	Meaning under GASB 23	Typical support
Reacquisition price	Amount required to repay the old debt in the refunding transaction.	Escrow deposit schedule, call premium, final settlement documents.
Net carrying amount	Amount due at maturity adjusted for unamortized premium/discount and issuance costs related to old debt.	Old debt amortization schedule and trial balance support.
Deferred amount on refunding	Difference between reacquisition price and net carrying amount.	Calculation workbook and amortization schedule.

Display and Amortization

Area	GASB 23 requirement	Practical review focus
Statement of net position	Under current guidance, report as a deferred outflow or deferred inflow of resources.	Present separately from the related debt liability; do not net against debt.
Statement of revenues, expenses, and changes in net position	Amortization reported as a component of interest expense.	Tie amortization to a systematic and rational method.
Amortization period	Shorter of remaining life of old debt or life of new debt.	Watch refundings that extend maturities.

Current vs. Advance Refundings

Feature	Current refunding	Advance refunding resulting in defeasance
Use of new debt proceeds	Repay old debt immediately.	Place proceeds with escrow agent until old debt service is paid later.
Reacquisition price	Principal of old debt plus any call premium.	Escrow deposit needed for principal, interest, and call premium.
Disclosure focus	Statement 7 disclosures applied to current refundings by proprietary activities.	Statement 7 advance refunding disclosures continue to apply.

Refunding a Prior Refunding

- When a proprietary activity refunds a prior refunding, the new difference is combined with any unamortized difference from the prior refunding.
- The combined amount is deferred and amortized over the shorter of the original remaining amortization period or the life of the latest refunding debt.
- Practical issue: prior deferred amounts can be easy to miss if the debt schedule is not rolled forward from the last issuance.

POLLING QUESTION #3

Under GASB 23, the difference between reacquisition price and net carrying amount is generally:

A. Recognized immediately as a gain or loss
B. Deferred and amortized as a component of interest expense
C. Recorded as capital revenue
D. Ignored if the refunding produces cash flow savings

Standards Changed Governmental Reporting

Before / concern	GASB 7 + GASB 23 response	Lasting impact
Diversity in advance refunding accounting	Governmental fund classification for proceeds and escrow payments.	Improved comparability of debt service trends.
Users could not see economic effect	Required cash flow differential and economic gain/loss disclosures.	Notes tell the financing story, not only the accounting result.
Proprietary activities showed immediate gains/losses	Deferred amount on refunding amortized via interest expense.	Better matching of refunding cost/benefit to future periods.

Connections to Current GASB

Current standard	Connection to GASB 7 / 23 concepts	Today's practical takeaway
GASB 65	Refunding differences are reported as deferred outflows or inflows of resources.	Present the deferred amount separately from the related debt liability.
GASB 88	Debt notes include essential information about direct borrowings and direct placements.	Do not treat debt disclosures as a rollforward only.
GASB 91	Conduit debt requires clarity about issuer obligations and commitments.	Understand who is primarily obligated and what commitments exist.

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Practical Checklist

- ✓ Official statement and closing memorandum
- ✓ Escrow agreement and verification report
- ✓ Old and new debt service schedules
- ✓ Call premium and issuance cost detail
- ✓ Cash flow differential and economic gain/loss calculation
- ✓ Deferred amount on refunding calculation and amortization
- ✓ Trustee confirmation of defeased debt outstanding
- ✓ Draft footnote cross-checked to debt schedules

Best practice: reconcile the accounting entry, amortization schedule, and debt footnote to the same set of underlying bond/escrow documents.

Common Disclosure Issues

- Description focuses only on new debt issuance and omits the old debt, escrow, call date, or reason for the refunding.
- Cash flow savings and economic gain/loss are not both disclosed when required.
- Deferred amount on refunding is recorded but not clearly presented or supported by amortization.
- Defeased debt outstanding is carried forward from prior year without current trustee support.
- Direct borrowings/direct placements or conduit debt commitments are not integrated with the broader debt note.

POLLING QUESTION #4

Which item is a strong audit procedure for a refunding disclosure?

A. Agree only the new debt principal to the trial balance
B. Recalculate the cash flow differential and economic gain/loss from debt service schedules
C. Skip trustee confirmations if management provides a footnote draft
D. Record the deferred amount directly to program revenue

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Key Takeaways

1. GASB 7 gave governments a consistent way to report advance refundings and disclose their economic effect.

2. GASB 23 changed proprietary activity reporting by deferring and amortizing refunding differences through interest expense.

3. The best disclosures explain both the transaction mechanics and the economic result.

4. Modern debt reporting continues the same theme: transparent obligations, risks, commitments, and future resource flows.

Questions?

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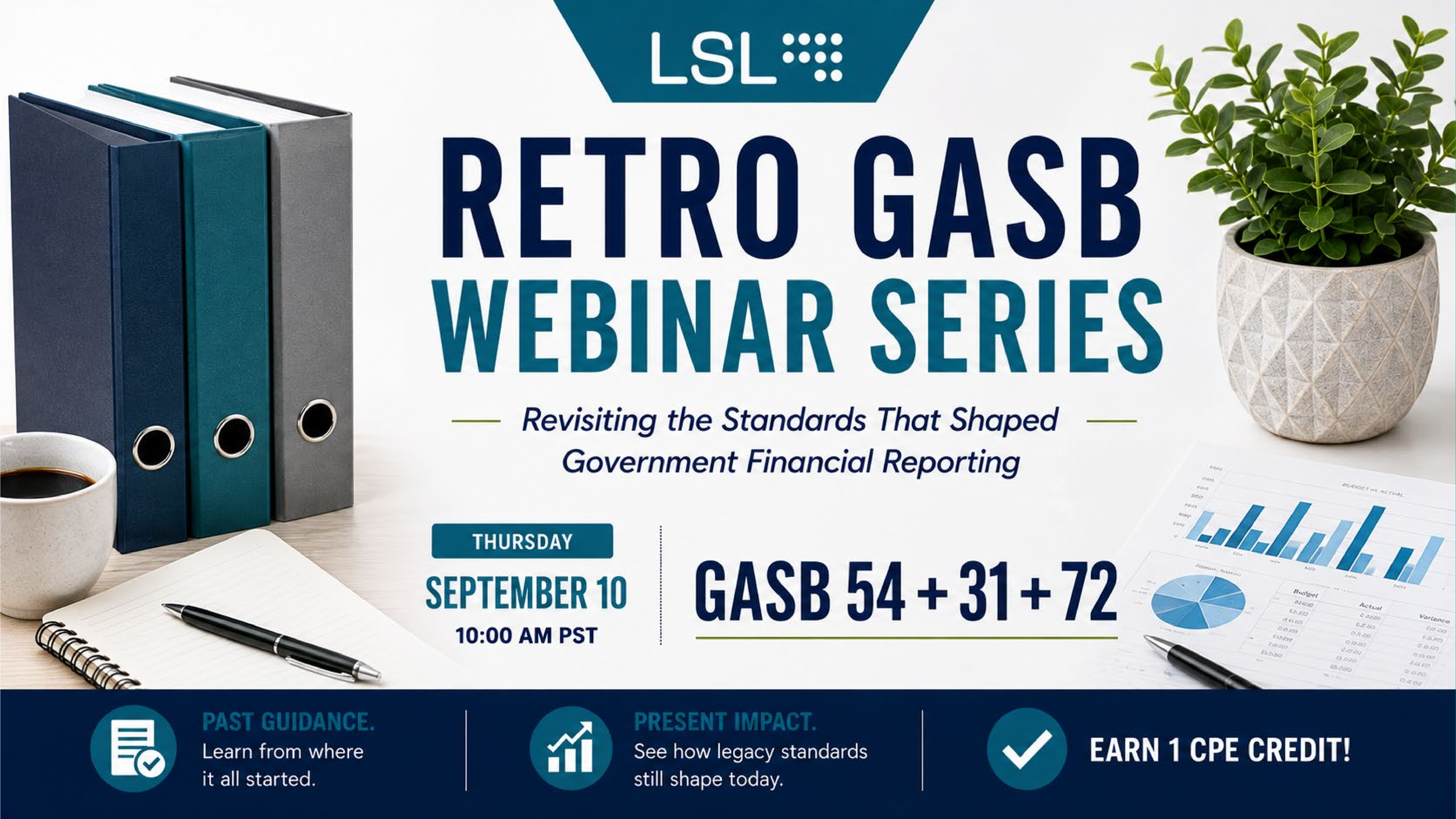
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