Chapter 6 Transactions Affecting General Long-Term Liabilities and Debt Service

The City of Smithville created a Street Improvement Bond Debt Service Fund to be used to retire the bonds issued for the purposes described in Chapter 5 of this cumulative problem, and to pay the interest on the bonds. The $1,000,000 worth of bonds issued during 2005 are dated January 1, 2005, but were not issued until April 1, 2005. The bonds are each in the denomination of $5,000, bearing a nominal annual interest rate of 7 percent per annum. The first interest payment is due July 1, 2005. Subsequent semiannual interest payments will be made January 1 and July 1 of each following year until the maturity of the bond. Forty bonds of $5,000 each are to mature 10 years after date of the bonds, and 40 bonds are to mature each year thereafter until all the bonds issued in 2005 have matured. Thus, these bonds are deferred serial bonds as discussed in Chapter 6 of the textbook. Make entries as instructed in the following paragraphs.

a. Prepare general journal entries, as necessary to record the transactions described in paragraph b in the Street Improvement Bond Debt Service Fund general journal and, if applicable, in the governmental activities general journal. Use account titles listed in the drop down Account #/Account Description menu for each of these accounting entities. Be sure to select year “2005” from the drop-down [Year] menu and the appropriate paragraph number shown in bold-face font below in the [Transaction Description] box.

b. Record the transactions below, as necessary.

1. [Para. 6-b-1] On April 1, 2005, an amendment to the annual budget for 2005 was approved by the City Council for inflows and outflows in the Street Improvement Bond Debt Service Fund related to the bond issue. The Debt Service Fund budget provides for estimated other financing sources of $22,500 for the premium on bonds sold and estimated revenues of $17,500 for accrued interest on bonds sold; and appropriations in the amount of the one interest payment of $35,000 to be made during 2005. (The payment due on July 1, 2005)

   **Required:** Record the budget for the Street Improvement Bond Debt Service Fund for Year 2005. Budgetary entries have no effect on the government-wide accounting records.

2. [Para. 6-b-2] On April 1, 2005, the premium and accrued interest on bonds sold were received by the Street Improvement Bond Debt Service Fund. (See Transaction 5-b-5 in the Street Improvement Fund.).

   **Required:** Record this transaction in the Street Improvement Debt Service Fund. No entry is required at this time in the governmental activities general journal since the bond issue, together with related premium and accrued interest, was recorded in the governmental activities general journal earlier in transaction 5-b-5.
3. **[Para. 6-b-3]** The July 1, 2005, interest payment was made. [Note: Since you credited Expense, Interest on Long-Term Debt for $17,500 in 5-b-5, you can record the full six months of interest as a debit to Interest Expense, less amortization.]

**Required:** Record this transaction in both the Street Improvement Debt Service Fund and the governmental activities general journals. For the entry in the governmental activities journal, assume that the appropriate amount of amortization of the Premium on 7% Deferred Serial Bonds for the three months the bonds have been outstanding (April 1 through July 1) is $408. [Note: Although premiums and discounts on bonds issued are not amortized in a debt service fund, they should be amortized at the government-wide level since the accrual basis of accounting is used at that level.]

4. **[Para. 6-b-4]** Make the required journal entry in the governmental activities general journal to accrue six months of interest payable on the 7% Deferred Serial bonds from the July 1 interest payment until the end of the fiscal year, December 31, 2005. For this entry, assume that the appropriate amount of amortization of the Premium on 7% Deferred Serial Bonds Payable is $817. [Note: Recall that interest is not accrued for the period July 1 to December 31, 2005, in the debt service fund as no appropriation exists for this expenditure and the interest is not due this fiscal year.]

5. Verify accuracy of journal entries, including dates and paragraph numbers, and, if you have not already done so, post all entries to the general ledger of both the Street Improvement Bond Debt Service Fund and governmental activities by clicking on [Post Entries]. Make the entries needed to close the budgetary and operating statement accounts at the end of fiscal year 2005. Make this entry only in the Street Improvement Fund Debt Service Fund Journal. Be sure for each account being closed to click on the check mark for [Closing Entry] and type “Closing Entry” in the [Transaction Description] box. [Note: Closing entries for governmental activities at the government-wide level will be made in Chapter 9 of this cumulative problem.]

c. Go to [Reports] and print the Pre-Closing and Post-Closing Trial Balance for the Street Improvement Bond Debt Service Fund as of December 31, 2005. Retain in your cumulative folder until directed by your instructor to turn it in, unless your instructor specifies submission of computer files via e-mail.

d. If the assessed valuation of property within the City of Smithville is $75,000,000, and the legal general obligation debt limit is 10 percent of assessed valuation, compute the legal debt margin of the City as of December 31, 2005. [Bonds authorized but unissued, as described in the introductory paragraph of Chapter 5 of the City of Smithville cumulative problem, should be included as if they are outstanding for purposes of this calculation, as well as the bonds actually outstanding.) Prepare a
schedule in good form showing calculation of the legal debt limit, debt subject to the limit, and debt margin (see Illustration 6-3 for an example).

**Fiscal year 2006 Transactions:**

e. The City of Smithville plans to issue additional Street Improvement Bonds in the total amount of $2,000,000 during early FY 2006. The new bonds will be of $5,000 denomination and will bear interest at the nominal annual rate of 7.2 percent. These bonds will be dated January 1, 2006.

The first interest payment on the new bonds will be due on July 1, 2006; interest will be payable January 1 and July 1 of each following year until maturity. Forty bonds of the 2006 issue will mature 10 years after date of issue, and 40 bonds will mature each year thereafter until all bonds of the 2006 issue have matured. To give you some additional practice on accounting for the Debt Service Fund, record the following events and transactions that are presumed to occur in fiscal year 2006 in the Debt Service Fund only. **You should ignore entries that would be required in the General Fund and in the governmental activities general journal related to these transactions for fiscal year 2006. However, a new fund, the Investment Pool Fund, has recently been created (see Chapter 8). The Investment Pool Fund will handle all investments of the Street Improvement Bond Debt Service Fund, effective 2006.**

1. **[Para. 6-e-1]** On January 1, 2006, the Debt Service Fund budget for 2006 was legally adopted. The budget provided for estimated other financing sources to be transferred from the General Fund in an amount equal to the $142,000 appropriations for interest for the year on all Street Improvement Bonds expected to be outstanding during the year (including those issued in 2005), plus an amount of $150,000 to be invested in the City of Smithville’s new Investment Pool Fund for eventual bond redemption ($292,000 in total). The budget also provided for estimated earnings of $7,115 on the Debt Service Fund’s equity in pooled investments of the Investment Pool Fund. No premium or accrued interest on bonds sold is included in the 2006 estimated other financing sources or estimated revenues; if the Debt Service Fund does receive such items from the Street Improvement Fund, they will be invested and used for eventual bond redemption and the budget will be amended to reflect such items.

2. **[Para. 6-e-2]** Cash in the amount of $35,000 was transferred from the General Fund as budgeted for the bond interest due on January 1, 2006 for the 7% deferred serial bonds issued for the Street Improvement Fund during 2005.

3. **[Para. 6-e-3]** Bond interest due on January 1, 2006 in the amount of $35,000 for the first issue of Street Improvement bonds (see Chapter 5 of this cumulative problem) was paid on that date.
4. [Para. 6-e-4] On March 1, 2006, the Debt Service Fund received $20,000 of premium from the sale of the additional $2,000,000 Street Improvement bonds, plus $24,000 for two months of accrued interest ($44,000 in total). The full $44,000 premium was transferred to the Investment Pool Fund until needed later for retirement of the bonds or for interest (debit Equity in Pooled Investments). Investments of the Investment Pool Fund are expected to earn an average of 6.5 percent per annum. Interest earnings will be added to the balance of the Equity in Pooled Investments account, upon notification from the Investment Pool Fund, generally at year-end. In addition to recording the receipt of $44,000 in cash, record an amendment to the FY 2006 budget to reflect the amounts of the premium and accrued interest on bonds sold. Also, record an additional estimated revenues for investment earnings in the amount of $2,385. [Note: You should credit Fund Balance for the full $46,385.][Note: Do not make any entries in the Investment Pool Fund until you begin Chapter 8 of the City of Smithville.]

5. [Para. 6-e-5] On June 30, 2006, the General Fund transferred in cash the remaining $257,000 budgeted for the Debt Service Fund; $150,000 was immediately transferred to the Investment Pool Fund, where it is expected to earn 6.5 percent per annum.

6. [Para. 6-e-6] Bond interest of $35,000 due July 1, 2006 on the 7% Street Improvement Bonds issued in 2005 and $72,000 on the 7.2% Street Improvement bonds issued in 2006 was paid on that date.

7. [Para. 6-e-7] Notification was received from the investment manager of the Investment Pool Fund that the debt service fund’s portion of interest accrued or received in cash at the end of FY 2006 on all investments held by the Investment Pool Fund amounted to $9,288. In addition, the investment manager advised that the debt service fund’s equity in appreciation in fair value of Investment Pool Fund investments amounted to $602 at year-end. (You should debit Equity in Pooled Investments and credit appropriate revenue accounts for these items.)

8. After verifying the accuracy of the preceding entries, post the amounts to the general ledger accounts by clicking [Post Entries]. Prepare closing entries for the Street Improvement Bond Debt Service Fund as of December 31, 2006. Be sure for each account being closed to click on the check mark for [Closing Entry] and type “Closing Entry” in the [Transaction Description] box. Post the closing entries to the general ledger by clicking [Post Entries].

f. Export the Post-Closing Trial Balance (click on [File]-[Export]) for year 2006 to Excel to prepare a Balance Sheet for the Street Improvement Bond Debt Service Fund as of December 31, 2006.

g. Export a Pre-Closing Trial Balance for year 2006 to Excel to prepare a Statement of Revenues, Expenditures, and Changes in Fund Balance for the Street Improvement Bond Debt Service Fund for the year ended December 31, 2006.
h. Use the same trial balance exported in item e above to prepare a Statement of Revenues, Expenditures, and Changes in Fund Balance--Budget and Actual for the Street Improvement Bond Debt Service Fund for the year ended December 31, 2006.

[Note: Retain a printout of all worksheets and your financial statements in your cumulative file until directed by your instructor to turn it in, unless your instructor specifies that you submit computer files via e-mail.]