Red Hot Topics for Bond Programs

ARE YOU IN COMPLIANCE?

ACBO Spring Conference 2016
Monterey, CA

Presentation Team

- Felipe R. Lopez — Compton CCD
  Chief Business Officer
- David G. Casnocha — Stradling Yocca Carlson Rauth
  Shareholder
- Renee S. Graves — Vicenti, Lloyd, Stutzman LLP
  Partner
- Joanna E. Bowes — KNN Public Finance
  Managing Parnter

Objective

- Discuss areas of risk regarding General Obligation bond program financing and reporting
- Implementation of compliance in critical areas
- Importance due to increased surveillance by Federal and State regulators and external auditors

Tax-Exempt Bonds

- Advantage of tax exemptions
- Why we have tax-exemption
- Why the IRS is the “police”

Issuance Compliance

- Federal Income Tax Law
- Section 103 Internal Revenue Code

Issuance Compliance

- Tax Certificate
  - Private Activity – no more than 5% of the proceeds of the Bonds will be used for a Private use that is unrelated to the governmental use of the proceeds of the Bonds…..
    - For purposes to the Tax Certificate - private use means any activity that constitutes a trade or business that is carried on by persons or entities, other than governmental entities.

Issuance Compliance

- Tax Certificate
  - Tax-exempt bonds are subject to Section § 1.148–2 - Reasonably Expectations as to when proceeds will be spent:
    - 85% will be spent within 3 years.
    - 5% will be obligated within 6 months.
  - Tax-exempt bonds “Hedge Bonds” are subject to Section 149 (g) -Reasonably Expectations as to when proceeds will be spent:
    - 10% will be spent within 1 year.
    - 30% will be spent within 2 years.
    - 60% will be spent within 3 years.
    - 85% will be spent within 5 years.

Issuance Compliance

- Tax Certificate
  - Rebate Compliance – District must comply with Section 148(f).
    - Actual investment earnings on bond proceeds (-) Earnings at Arbitrage Yield
      - "Positive Arbitrage" = Actual Earnings > Earnings @ arbitrage yield.
      - "Negative Arbitrage" = Actual Earnings < Earnings @ arbitrage yield.
    - Excess funds earned must be paid to the United States Treasury.
      - Issuers shall pay installments at least once every 5 years after the issue date.
    - No filing required if no payment is due.

Post-Issuance Compliance

- Internal Controls
- Continuing Disclosure Certificate
- Arbitrage/Rebate Compliance

Post-Issuance Compliance

- Internal Controls
  - Assign responsible personnel of the District to monitor and ensure compliance.
  - Develop <u>written</u> policies and procedures.
  - Provide adequate training to responsible District personnel.
  - Regularly review the restrictions of the Tax Certificate.
  - Regularly consult with Bond Counsel and other District advisors.
  - On-going record keeping

Post-Issuance Compliance

- Continuing Disclosure Certificate
  - Annual Report (9 months after year-end) – elements of the report include but not limited to the following:
    - Audited Financial Statements of the prior fiscal-year.
    - Material financial information and operating data.
    - Report must be filed in electronic format.
  - Reporting of Significant Events – events include but not limited to the following:
    - Principal and interest payment delinquencies.
    - Tender offers.
    - Defeasances.
    - Rating changes.
    - Adverse tax opinions.

Post-Issuance Compliance

- Continuing Disclosure Certificate
  - Termination of Reporting Obligations
    - District obligations shall terminate upon the legal defeasance, prior redemption or payment in full of all the Bonds.
  - Dissemination Agent
    - Due to the complex requirements – highly recommend District's use a dissemination agent to assist in carrying out its obligations under the Disclosure Certificate.

Audit Compliance

- Financial and Performance Audits in accordance with *Government Auditing Standards*
  - *Accountability requirements in Article 13A Section 1(b)(3) of the California Constitution:*
    - *Proceeds used only for voter approved projects related to school facilities*
    - *Proceeds cannot be used for administrator salaries or operating expenses*
    - *Annual performance audit to ensure funds expended on specific projects listed*
    - *Annual financial audit to ensure funds expended for school facilities projects*

Audit Compliance

- Financial and Performance Audits in accordance with Government Auditing Standards
  - ECS 15286
    - Requires both audits to be conducted using Government Auditing Standards
    - Requires both audits to be submitted to the COC at the same time they are submitted to the District
    - Requires both audits to be submitted to the COC and District by March 31

Audit Compliance

- Common Findings – Financial Audit
  - No accrual for retention on projects
  - No accrual for work done through June 30
  - Bond proceeds recorded at net rather than gross
  - Interest not allocated to the bond fund
  - Financial/ Budget reports provided to the COC do not reconcile to the General Ledger
  - Difficulty in verifying projects to the ballot language
  - Proper accounting for investments, including realized/ unrealized gains (losses)

Audit Compliance

- Common Findings – Performance Audit
  - COC does not hold regular meetings
  - COC is unable to achieve a quorum
  - COC composition does not comply with ECS 15282
  - Website is not kept up-to-date (ECS 15280)
    - Minutes shall be available on the internet
    - Documents and reports shall be available on the internet
  - Annual report is not issued

Audit Compliance

- Areas that can cause confusion:
  - Board not understanding the purpose of the financial and performance audits
  - COC not understanding their role
  - Integrating the ballot language with the master plan
  - Spending bond proceeds on technology or other assets with a life shorter than the debt service payments
  - Issuance of a separate financial audit report

MCDC

- Process gained momentum
  - Investment banking firms paid fines
- Letters now to issuers
  - No fine but settlement
  - Adopt CDC procedures publically

Tips to Avoid Problems

- Establish policies and procedures to monitor compliance.
- Be familiar with your bond documents – especially the tax and continuing disclosure certificates.
- Create a file to retain information needed for the calculation right after the bond closing:
  - Avoid having to find records from 5-years ago.
  - Obtained missing documents from Bond Counsel.
  - Documentation is extremely important.

Tips to Avoid Problems

- Schedule your arbitrage rebate calculation – consider having calculations prepared more frequently then at the 5-year date.
- Conservatively size bond issuances for costs during a 3 year period; don’t chase interest rates.
- Make sure contracts are bid and there are no procedural delays potentially hindering expenditure.
- Make prompt spending of proceeds a priority.

Questions