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

JANET COWELL
TREASURER

GREGORY C. GASKINS
DEPUTY TREASURER

Memorandum # 2016-02

TO: All Local Governments, Public Authorities and Certified Public Accountants

FROM: Sharon Edmundson, Director, Fiscal Management Section

SUBJECT: Accounting for Long-Term Revolving Loans

DATE: August 3, 2015

The purpose of this memo is to provide guidance on accounting for revolving loan programs, the most common being CDBG. This memo was written after consultation with GASB and the UNC School of Government. **Nothing in this memo alters the way funds are treated for purposes of the federal and/or State compliance auditing and reporting. This memo addresses only the accounting for and reporting of loans and the related transactions in a unit's financial statements.**

Many units in North Carolina present revolving loans on their operating statements and balance sheet/statement of net position. After consulting with multiple leaders in the accounting profession we have concluded that this long standing practice may no longer meet current accounting standards or Generally Accepted Accounting Principles (GAAP). Attachment B to this memo discusses the various GASB citations used in developing this guidance.

In North Carolina, General Statute 159 generally requires units to budget the receipt and disbursement of money. This memo includes illustrative journal entries that show the user how to record the entries on the operating statement and how to use contra accounts to convert the general ledger back to a GAAP set of books. Each unit of government will need to consider the timing and placement of the journal entries, especially the contra accounts, so that the ability of the unit's accounting system to track the budgets for revenues and expenditures is not disrupted.

In order to determine the proper accounting and reporting treatment for a unit's program, it must first determine if the funds disbursed are truly loans as defined by GAAP. Simply because a disbursement is called a loan does not make it a loan for reporting purposes. If a transaction is structured so that the unit reasonably expects to be repaid at some future date, it should be treated as a loan. If a transaction is structured so that loan repayment is unlikely, then the unit (we recommend consultation with your auditor) may use its

3200 ATLANTIC AVENUE, RALEIGH, NORTH CAROLINA 27604
Courier #56-20-45 Telephone: (919) 814-4300 Fax: (919) 855-5812
Website: www.nctreasurer.com

judgment to treat the transaction as a grant. If the unit determines the transactions are grants then the transactions are not recorded on the balance sheet but instead as an expenditure/expense on the operating statement.

Accounting for Revolving Loans

GAAP requires loans to be reported on the balance sheet and net position statements and not on the operating statements. However, North Carolina law requires loans to be budgeted as expenditures in the year the loan is made and as revenue in the years the repayments are received. The entries in Attachment A use contra accounts to allow the unit to record the budgetary entries in the revenue and expenditure accounts and contra accounts to offset the revenue and expenditure accounts; these entries will move the transaction to the balance sheet/net position statements so the books will easily convert to a GAAP presentation. Remember, if the budget-to-actual statements in your financial report are different from the operating statements you will need to include a reconciliation statement between the two.

If you have any questions, please contact Melinda Canady at 919-814-4302.

BUDGETARY AND ACCOUNTING JOURNAL ENTRIES ATTACHMENT A

Lender's Books

First Year

Receipt of federal/State Funds-The funds could be structured to be provided in advance to the unit of government or on a reimbursement basis. Most units receive funds from the government on the reimbursement basis so the following entries are based on that assumption.

Reimbursement Funding						
Budget Entries				***Actual Entries***		
Increase	Loan Expenditure	$	50,000	Dr	Cash	$ 50,000
Increase	Loan Revenue	$	50,000	Cr	Loan Revenue	$ 50,000

Loans made to a person or entity outside the government – unit of government expects the loan to be repaid in a future year.

Budget Entries		***Actual Entries***		
Budget entry already made above		Dr	Expenditure/Expense	$ 50,000
		Cr	Cash	$ 50,000
		Dr	Loan Receivable	$ 50,000
		Cr	Expenditure/Expense contra acct.	$ 50,000

Second Year

Loan payments are received by the unit of government

Budget Entries	***Actual Entries***		
Your annual budget should include a revenue for loan payments (principal and interest) you expect to receive for the fiscal year. If you plan to re-lend the funds it should also include an expenditure for the amount you expect to re-lend.	Dr	Cash	$ 7,500
	Cr	Revenue	$ 5,000
	Cr	Interest income	$ 2,500
	Dr	Revenue contra account	$ 5,000
	Cr	Loan Receivable	$ 5,000

Third Year

In the third year the borrower of the funds comes to the board and makes a case that they should not have to pay back the loan. The board acknowledges that the entity is contributing to the community and forgives the debt.

Budget Entries	***Actual Entries***		
The unit of government does not budget the receipt of more loan payments. The debt forgiveness does take board action.	Dr	Expenditure/Expense	$ 45,000
	Cr	Loans Receivable	$ 45,000

TECHNICAL GUIDANCE ATTACHMENT B

Paragraph 21 of GASB Statement 33, as amended, provides the general guidance for reporting revenue for voluntary nonexchange transactions, such as most federal grants:

> Providers should recognize liabilities (or a decrease in assets) and expenses from government-mandated or voluntary nonexchange transactions, and recipients should recognize receivables (or a decrease in liabilities) and revenues (net of estimated uncollectible amounts), when all applicable eligibility requirements, including time requirements, are met. Resources transmitted before the eligibility requirements are met (excluding time requirements) should be reported as assets by the provider and as liabilities by the recipient. Resources received or recognized as a receivable before time requirements are met, but after all other eligibility requirements have been met, should be reported as a deferred outflow of resources by the provider and a deferred inflow of resources by the recipient. [GASBS 33, ¶21, as amended by GASBS 65, ¶10]

The following items in the GASB Comprehensive Implementation Guide, 2014, address some aspects of accounting for loans:

> 7.70.3. Q—How should a government report a change in the allowance for uncollectible accounts that relates to loans receivable and is therefore not related to a revenue account? (Q&A34B-100)
> A—The change in an uncollectible loan allowance account should be reported as an expense—there is no related revenue account to reduce. A forgiven or uncollectible loan becomes, in substance, a gift, grant, or contribution, and is properly reported as an expense.

> Z.54.48. Q—If a portion of the corpus of a permanent fund is required to be used to make loans, should that portion of fund balance be classified as nonspendable, or restricted, because the proceeds from collections are restricted to the making of new loans? (Q&A2011-Z.54.48)
> A—Fund balance should be classified as nonspendable. The primary determinant for classification is that the corpus cannot be "spent." Making a loan, in this example, is not considered "spending" for financial reporting purposes.

In addition, paragraph 6 of Statement 54 shows that long term receivables (including loan receivables) are balanced by fund balance, not deferred inflow of resources:

Statement 54, paragraph 6. "The nonspendable fund balance classification includes amounts that cannot be spent because they are either (a) not in spendable form or (b) legally or contractually required to be maintained intact. The "not in spendable form" criterion includes items that are not expected to be converted to cash, for example, inventories and prepaid amounts. It also includes the long-term amount of loans and notes receivable, as well as property acquired for resale. However, if the use of the proceeds from the collection of those receivables or from the sale of those properties is restricted, committed, or assigned, then they should be included in the appropriate fund balance classification (restricted, committed, or assigned), rather than nonspendable fund balance. The corpus (or principal) of a permanent fund is an example of an amount that is legally or contractually required to be maintained intact."