governing board or a sufficient combination of these characteristics to demonstrate their independent existence from the nursing home, the financial reporting of these organizations should be separate from reports of the nursing home. If such organizations are under the control of (or common control with) nursing homes and handle nursing home resources, their financial reports should be combined with those of the nursing home.

DEBT FINANCING FOR PLANT REPLACEMENT AND EXPANSION PURPOSES

Debt financing for plant replacement and expansion programs may take many forms. Under the terms of most debt financing agreements the debtor is required to perform or is prohibited from performing certain acts. In many instances such financing gives rise to special accounting treatment because of discounts and premiums on bond issues, financing charges, formal restrictions on debt proceeds, sinking and other required funds.

Discounts and Premiums on Bond Issues

Discounts and Premiums arising from the issue of bonds must be amortized over the life of the related issue(s). For reporting purposes, bond discounts must be reported as a reduction of the related debt (Bonds Payable - Net of Unamortized Discount). Bond premium must be reported as Other Deferred Credits.

ACCOUNTING PRINCIPLES (Cont'd)

Financing Charges

All costs of obtaining debt financing other than discounts (e.g., legal fees, underwriting fees, special accounting costs) should be recorded as deferred costs and amortized over the life of the related debt.

Accounting for Debt Proceeds

Debt agreements which finance plant replacement and expansion programs may or may not require formal segregation of debt proceeds prior to their use. Proceeds which are not required to be formally segregated prior to their use should be reported as other non-current assets in the unrestricted funds. However, proceeds which require formal segregation have been recorded in several ways, specifically:

1) as a separate restricted fund which includes all of the attendant liabilities and any required equity contribution as in the case of financing through N.Y. State Housing Finance Agency, or;
2) as a part of the restricted plant, replacement and expansion funds, which include all of the attendant liabilities, or;
3) the liabilities are reflected in the unrestricted fund and only the proceeds are reflected in a restricted fund. The proceeds, however, are not considered as an addition to the

ACCOUNTING PRINCIPLES (Cont'd)

restricted fund balance but rather as a liability to the unrestricted fund. This liability is reduced as the proceeds are used for their intended purposes.

For the purposes of this manual all funds received from debt arrangements which require formal segregation and/or separate accountability shall be reported in the plant replacement and expansion funds until such time as the project is completed and used. This fund will include all construction in progress costs and all liabilities related to the debt arrangement and construction project.

There may be instances where a portion of a restricted project's costs are to be funded from unrestricted resources. In these instances, any unrestricted funds required for the project will be transferred to the plant replacement and expansion funds and considered to be part of the depreciation funding requirement for the period in which the transfer of funds is made. However, any excess funding arising from the transfer of such assets will be accounted for as an interfund receivable/liability (Accounts 1374.00 and 2644.00 respectively) between the unrestricted funds and the plant replacement and expansion funds rather than additions/reductions to the fund balances of such funds.

ACCOUNTING PRINCIPLES (Cont'd)

When the project is completed the assets and liabilities of the project will be transferred to the appropriate unrestricted fund asset and liability accounts except for any residual liquid assets that may be restricted for future specified use under the debt agreement. Such excess restricted assets must remain in the plant replacement and expansion funds. However, if the source of such excess funds are from the proceeds of the debt financing arrangement an interfund receivable/liability (Accounts 1374.00 and 2644.00 respectively) must be established between the unrestricted fund and the plant replacement and expansion funds, since the debt financing liability will be in the unrestricted funds. Any income generated from the investment of such funds will be either added to the appropriate plant replacement and expansion fund balance if restricted or added to non-operating revenue in the unrestricted funds if available for general purposes.

The aforementioned treatment of restricted project funds would be applicable to New York State Housing Finance Agency (Article 28A) financing, New York State Dormitory Authority financing and any other financing which requires segregation and/or separate accountability of project funds.

To illustrate the accounting treatment of a restricted project assume the following:

ACCOUNTING PRINCIPLES (Cont'd)

1. A nursing home has decided to construct a new wing to the existing structure. The project is estimated to cost approximately $10,000,000. As a part of the financing for this project the nursing home has entered into a mortgage debt agreement with a third party which requires:

   a. The proceeds ($10,000,000) from the debt financing are to reside in the hands of a trustee designated by the mortgagee. $9,000,000 of the proceeds is available for project costs and the Trustee will pay project creditors directly upon receipt by the trustee of approved bills. The balance of $1,000,000 must be set aside in a restricted retirement of indebtedness fund for the purpose of retiring a portion of the debt in a future period to be determined at the discretion of the lender. The income from the investment of such funds is restricted for the same purpose.

   b. The nursing home must provide 10% ($1,000,000) of the estimated project cost from available equity funds. These funds must be turned over to a trustee designated by the mortgagee. The funds will be disbursed in the same manner as outlined in requirement 1.a.

ACCOUNTING PRINCIPLES (Cont'd)

2. The equity requirement of $1,000,000 will be provided from unrestricted assets of $400,000 and the balance of $600,000 will be provided from assets available for this purpose in the restricted plant replacement and expansion fund.

The accounting entries necessary to properly reflect the above transactions would be:

(1)
Plant Replacement and Expansion Funds

	Account		
DR. Cash and investments held in escrow	1526.00	$10,000,000	
CR. Mortgage Payable	2651.00		$10,000,000

To record the mortgage payable and the proceeds from such financing in the PR&E funds.

(2)
Unrestricted Funds

DR. Due from restricted project funds - non-current	1374.00	$ 400,000	
CR. Cash	1010.00		$ 400,000

NOTE: For this example assume that the nursing home has already provided for its depreciation funding requirement irrespective of the $400,000 equity provision indicated above. Therefore, this amount will be accounted for as an interfund receivable/liability.

ACCOUNTING PRINCIPLES (Cont'd)

Plant Replacement and Expansion Funds

DR. Cash and investments held in escrow	1526.00	$ 400,000	
CR. Due to operating funds - restricted project funds	2644.00		$ 400,000

To record the transfer of unrestricted fund assets to the PR&E fund for the partial satisfaction of the equity portion of the construction project.

(3)
Plant Replacement and Expansion Fund

	Account		
DR. Cash and investments held in escrow	1526.00	$ 600,000	
CR. Fund balance - restricted project funds	2691.00		$ 600,000
DR. Fund balance - donor restricted funds	2695.00	$ 600,000	
CR. Cash	1510.00		$ 600,000

To record the transfer of cash to the project trustee and the intra-fund transfer from the donor restricted fund to the restricted project fund.

ACCOUNTING PRINCIPLES (Cont'd)

Additional assumed facts during the construction period are as follows:

1. Construction costs from all sources (excluding capitalized interest) to date aggregate $9,500,000. The project trustee has paid $8,500,000, retained $700,000 and has yet to pay $300,000.

2. The accrued interest expense due to the mortgagee and fully paid to date from the restricted project funds is $1,000,000.

3. The investment income generated to date from investments of project funds by the trustee aggregates $550,000 of which $50,000 is attributable to the funds restricted for the retirement of indebtedness.

4. The project is completed and transferred to the unrestricted funds.

5. The outstanding contract and retention liabilities of $300,000 and $700,000, respectively which were transferred to the unrestricted funds are paid by the restricted project funds.

ACCOUNTING PRINCIPLES (Cont'd)

The accounting entries necessary to properly reflect the above transactions would be:

(4)
Plant Replacement and Expansion Funds

	Account		
DR. Construction in progress	1610.00	$9,500,000	
CR. Cash and investments held in escrow	1526.00		$ 8,500,000
CR. Construction retention payable	2617.00		$ 700,000
CR. Construction contracts payable	2618.00		$ 300,000

To record construction in progress to date and to recognize the appropriate construction liabilities.

(5)
Plant Replacement and Expansion Funds

	Account		
DR. Construction in progress capitalized interest	1616.00	$1,000,000	
CR. Cash and investments held in escrow	1526.00		$1,000,000

ACCOUNTING PRINCIPLES (Cont'd)

To record the capitalization of interest due and paid to date during the construction period.

(6)
Plant Replacement and Expansion Funds

	Account		
DR. Cash and investments held in escrow	1526.00	$ 550,000	
CR. Construction in progress capitalized interest	1616.00		$ 500,000
CR. Fund balance - retirement of indebtedness funds	2693.00		$ 50,000

To record the applicable income on investments earned during the construction period as an offset to capitalized interest and to recognize as an addition to fund balance that portion of the income restricted for retirement of indebtedness.

(7)
Plant Replacement and Expansion Funds

	Account	
DR. Mortgage payable	2651.00	$10,000,000
DR. Construction retention payable	2617.00	$ 700,000
DR Construction contracts payable	2618.00	$ 300,000
DR. Due to operating funds - restricted project funds	2644.00	$ 400,000

ACCOUNTING PRINCIPLES (Cont'd)

	Account		
DR. Fund balance - restricted project fund	2790.00	$ 600,000	
CR. Construction in progress	1610.00		$10,000,000
CR. Due to operating funds - restricted project funds	2644.00		$ 1,000,000
CR. Due to operating funds - retirement of indebtedness funds	2641.00		$ 1,000,000

Unrestricted Funds

DR. Property, plant and equipment	1140.00-1200.00	$10,000,000	
DR. Due from retirement of indebtedness funds - non-current	1371.00	$ 1,000,000	
DR. Due from restricted project funds - non-current	1374.00	$ 1,000,000	
CR. Construction retention payable	2117.00		$ 700,000
CR. Construction contracts payable	2118.00		$ 300,000
CR. Due from restricted project funds - non-current	1374.00		$ 400,000

ACCOUNTING PRINCIPLES (Cont'd)

CR. Mortgages payable	2151.00	$10,000,000
CR. Unrestricted operating fund balance	2290.00	$ 600,000

To record the following (1) transfer of the assets and related liabilities to the unrestricted funds, (2) recognition of the receivable from the restricted project funds to pay for the construction liabilities transferred to the unrestricted funds (Retention payable-$700,000 and contracts payable-$300,000), (3) recognition of the reduction of the interfund receivable/liability between the unrestricted funds and the restricted project funds for the completed project assets purchased from unrestricted funds of $400,000, and (4) recognition of the interfund receivable/liability between the unrestricted fund and the retirement of indebtedness funds, for the restriction of debt proceeds of $1,000,000 for that purpose.

(8)
Plant Replacement and Expansion Fund

	Account	
DR. Due to operating funds - restricted project funds	2644.00	$ 1,000,000

ACCOUNTING PRINCIPLES (Cont'd)

CR. Cash and investments held in escrow	1526.00		$ 1,000,000
Unrestricted Funds			
DR. Construction retention payable	2117.00	$ 700,000	
DR. Construction contracts payable	2118.00	$ 300,000	
CR. Due from restricted project funds - non-current	1374.00		$ 1,000,000

To record the payment of unrestricted fund project liabilities by the restricted project fund.

The balance sheets of the nursing home prior to the project and debt financing and at various points during and after the completion of the project, assuming no other financial activities occurred other than those described in the example, are as follows:

	Assumed balance prior to the project and debt financing	Balances after entries (1) thru (6)	Balances after entries (1) thru (7)	Balances after entries (1) thru (8)
UNRESTRICTED FUNDS				
Assets				
Current assets	$ 5,000,000	4,600,000	4,600,000	4,600,000
Plant assets, net	5,000,000	5,000,000	15,000,000	15,000,000

ACCOUNTING PRINCIPLES (Cont'd)

	Assumed balance prior to the project and debt financing	Balances after entries (1) thru (6)	Balances after entries (1) thru (7)	Balances after entries (1) thru (8)
Due from restricted project funds	-	400,000	1,000,000	-
Due from retirement of indebtedness funds	-	-	1,000,000	1,000,000
	$10,000,000	10,000,000	21,600,000	20,600,000
Liabilities and Fund Balances				
Current liabilities	$ 3,000,000	3,000,000	4,000,000	3,000,000
Mortgage payable	-	-	10,000,000	10,000,000
Fund balance	7,000,000	7,000,000	7,600,000	7,600,000
	$10,000,000	10,000,000	21,600,000	20,600,000
	PLANT REPLACEMENT AND EXPANSION FUNDS			
Assets				
Cash	$ 700,000	100,000	100,000	100,000
Cash and investments held in escrow	-	2,050,000	2,050,000	1,050,000
Investments	700,000	700,000	700,000	700,000
Construction in progress	-	10,000,000	-	-
	$ 1,400,000	12,850,000	2,850,000	1,850,000

ACCOUNTING PRINCIPLES (Cont'd)

	Assumed balance prior to the project and debt financing	Balances after entries (1) thru (6)	Balances after entries (1) thru (7)	Balances after entries (1) thru (8)
Liabilities and Fund Balances				
Construction contracts payable	-	300,000	-	-
Construction retention payable	-	700,00	-	-
Mortgage payable	-	10,000,000	-	-
Due to operating funds - retirement of indebtedness funds	-	-	1,000,000	1,000,000
Due to operating funds - restricted project funds	-	400,000	1,000,000	-
Fund balance - donor restricted funds	1,400,000	800,000	800,000	800,000
Fund balance - restricted project funds	-	600,000	-	-
Fund balance - retirement of indebtedness funds	-	50,000	50,000	50,000
	$ 1,400,000	12,850,000	2,850,000	1,850,000

Sinking and Other Required Funds

These funds are usually established to comply with loan provisions whereby specific deposits are to be used to insure that adequate funds are available to meet future payments of:

1. Interest and principal (retirement of indebtedness funds);

or

ACCOUNTING PRINCIPLES (Cont'd)

2. property insurance, related taxes, repairs and maintenance costs, equipment replacement (escrow, funds).

Funds of this nature may also be required to be held by trustees outside the nursing home. Income generated from the investment of such funds may be immediately available to the nursing home or such income may be held by the trustee for some future designated purpose.

For the purpose of this manual all sinking and other required funds will be accounted for in the following manner:

1. All fund assets, whether trusteed or otherwise, will be reported in the plant replacement and expansion funds. However, if the source of such funds are either from the proceeds from debt financing and the liability is a part of the unrestricted funds (see the example included in the Section <u>Accounting for Debt Proceeds</u>) or from previously unrestricted resources, then the transfer of such assets to the plant replacement and expansion fund must be accounted for as an interfund receivable/liability (See account groups 1370.00 and 2640.00).
2. All income generated from the investment of such funds will be reported, as earned, in appropriate plant replacement and expansion fund balance. When such income is available for