Department of Legislative Services

Maryland General Assembly
2003 Session

FISCAL AND POLICY NOTE
Revised

Senate Bill 126 (Senator Lawlah, *et al.*)
(Joint Committee on the Management of Public Funds)

Budget and Taxation Appropriations

General Obligation Bonds - Accounting for Proceeds

This emergency bill alters the accounting basis for the expenditure of State bond proceeds from a project accounting basis to a cash flow accounting basis. In addition, the Comptroller is authorized to restate prior expenditures of bond proceeds to comply with federal tax laws to avoid anticipated State liability for arbitrage earnings.

Fiscal Summary

State Effect: Federal tax liability on unexpended bond proceeds would decrease by $1.5 million in FY 2003 and $4.9 million in FY 2004 and each year thereafter. Any administrative costs associated with implementing the accounting change are assumed to be minimal and can be covered with existing resources within the Comptroller's and Treasurer's offices.

(in dollars)	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007
Revenues	$0	$0	$0	$0	$0
GF Expenditure	(1,500,000)	(4,900,000)	(4,900,000)	(4,900,000)	(4,900,000)
Net Effect	$1,500,000	$4,900,000	$4,900,000	$4,900,000	$4,900,000

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: None.

Small Business Effect: None.

Analysis

Bill Summary: This bill establishes a State and Local Facilities Loan Fund for the purpose of allocating bond proceeds to capital projects. The fund includes a premium and expense account. For accounting purposes, the fund includes a capital project account for each enabling act and separate subaccounts for each project included in enabling acts authorizing multiple projects.

Upon approval by the Board of Public Works, the Comptroller may expend money from the fund for any project authorized by an enabling act. The Comptroller must account for all expenditures from the fund on a project-specific basis. The Comptroller must pay the expenses of each bond sale from the proceeds of that bond sale credited to the premium and expense account. After the expenses have been paid, the remaining proceeds from the bond sale are transferred to the Annuity Bond Fund to pay debt service on those bonds and if approved by the Board of Public Works, the costs of other capital projects. In addition, the Comptroller may transfer unexpended proceeds from prior sales of State bonds to the State and Local Facilities Loan Fund.

Current Law: State law requires that bond proceeds be allocated to individual capital project accounts and expended only on those individual projects. If a specific project is not ready to move forward when the bond financing becomes available, the bond proceeds are not expended and remain in the individual capital project account.

Background: At the October 15, 2002 meeting of the Joint Committee on the Management of Public Funds, the State Treasurer discussed the need to enact legislation changing the accounting basis for the expenditure of bond proceeds from a project accounting basis by which bond proceeds are allocated to a specific project to a cash flow accounting basis by which bond proceeds are allocated to one fund and expended as needed on any authorized capital projects. The State Treasurer contends that the current accounting method is inefficient and results in the accumulation of unexpended proceeds for some projects and deficits for other projects.

According to the Comptroller's Office, approximately $100 million in bond proceeds have accumulated in individual project accounts for capital projects that are not currently ready to move forward while $200 million is needed for projects that are ready to be funded. Pursuant to this legislation, the Comptroller's Office will be able to use the unexpended bond proceeds for projects that are ready to move forward.

A cash flow accounting basis would also minimize federal rebate liability on unexpended bond proceeds. The federal tax law of 1986 requires an entity that sells tax exempt bonds to spend down the proceeds within 18 to 24 months, depending on the project. This law prevents arbitrage abuses by which an entity earns a higher rate of interest from the investment of bond proceeds than the interest paid on the bonds.

The federal tax liability calculation is made on the fifth anniversary of a bond sale. Since the State still has unexpended proceeds from the 1998 bond sale, the State will incur a federal tax liability in fiscal 2003. The federal tax law allows for either project or cash flow basis accounting. The State can modify its accounting method anytime before the arbitrage calculation. Pursuant to this legislation, the State will be able to reallocate the proceeds from the 1998 bond sale, thus enabling the State to spend down the bond proceeds over a two-year period and thereby avoiding the federal tax liability.

State Fiscal Effect: Under the State's current accounting basis, bond proceeds are allocated to individual capital project accounts and expended only on those individual projects. If a specific project is not ready to move forward when the bond financing becomes available, the bond proceeds are not expended and remain in the individual capital project account. Until the capital project is ready, the State earns interest on the unexpended bond proceeds. If the bond proceeds are not expended within a certain period and the interest earnings from the investment of the bond proceeds exceed the interest paid on the bonds, the State has to pay federal taxes on the additional interest earnings.

The State Treasurer advises that absent the enactment of this emergency legislation, the State would have to pay the federal government $1.5 million in federal tax rebate liability in fiscal 2003. The projected federal tax rebate liability is expected to total $4.9 million annually beginning in fiscal 2004. The fiscal 2003 State budget included $3.5 million to cover the federal tax liability in fiscal 2003. The proposed fiscal 2004 State budget does not include any funds for this purpose.

Any administrative costs associated with implementing the accounting change are assumed to be minimal and can be covered with existing resources within the Comptroller's and Treasurer's offices. The computer system used by the Comptroller's Office can accommodate both accounting systems.

Additional Information

Prior Introductions: None.

Cross File: HB 139 (Delegate Heller, *et al.*) – Appropriations.

Information Source(s): Comptroller's Office, Maryland State Treasurer's Office, Department of Legislative Services

Fiscal Note History: First Reader - February 3, 2003
mld/jr Revised - Enrolled Bill - April 23, 2003

Analysis by: Hiram L. Burch Jr.

Direct Inquiries to:
(410) 946-5510
(301) 970-5510