Procedure 720 Certificates of Participation (COPs)

An issuance of certificates of participation (COPs) is a mechanism for providing capital to school districts and county offices to purchase equipment, finance construction projects, or refinance existing leases. This financing technique provides long-term financing through a lease with an option to purchase or a conditional sales agreement.

The major disadvantage of a COP is that there is no repayment source connected to its issuance, such as there is with an issuance of general obligation debt. The lease obligation is payable out of the general fund or from other available revenues.

Accounting for Certificates of Participation

The following points are important to understanding how certificates of participation are accounted for in conformity with generally accepted accounting principles (GAAP):

1. The financing of certificates of participation typically involves the following parties:

   Lessee (Issuer)—A school district or county office of education

   Lessor—A nonprofit corporation, joint powers authority, leasing company, bank, or other entity that holds title to the equipment during the lease period

   Trustee—A commercial bank or trust company that receives the proceeds, collects the lease payments on behalf of the lessor, and/or repays the notes. The trustee is required to adhere to the standards in the trust agreement and maintain the trust fund accounts. The trust fund accounts show all disbursements made against the certificates of participation's proceeds as well as any interest earned.

   Underwriter—A municipal securities dealer who commits to the purchase of the certificates and remarkets them to investors. The underwriter will charge a fee, known as the underwriter's discount, to assume the underwriting risk of the COPs.

2. At the time the proceeds of the COPs are deposited with the trustee, the money legally belongs to the local educational agency (LEA). Therefore, at this time, the LEA must record the proceeds in its books.

3. The proceeds of the COPs should be reported in the fund that will be used to acquire or construct the assets. This will typically be the general fund or a capital projects fund.

   School districts may identify developer fees as the repayment source for COPs. If this is the case, the LEA will record the proceeds of the COPs in the Capital Facilities Fund.

4. The LEA must review the section of the COPs documents titled "Sources and Uses of Funds" to determine the opening entry needed on the LEA's books to account for the COPs. The following sources or uses of funds will typically be found:

Accrued Interest—The amount of interest accrued on COPs from the issue date until closing. The underwriter pays this amount to the trustee at closing, and the money is held by the trustee in the lease payment account as a credit toward the first scheduled lease payment. For this reason, the accrued interest is recorded as interest payable.

Capitalized or Funded Interest—The amount of interest on a COP that will accrue from the COP's issue date to the date the project or property being financed is projected to be completed. California law precludes issuers from making lease payments unless they have constructive use or occupancy of the property being financed. The funded interest is a component of the COP's proceeds and is used to pay the investors their semiannual interest payments during the construction period. As a matter of practice, funded interest normally extends two to three months beyond the projected completion date to cover unforeseen delays.

Reserve Account (Reserve for Debt Service)—Underwriters typically require a debt service reserve funded by the proceeds of the COP. The reserve is held by the trustee to pay investors in the event of the issuer's default or in the case of late payment. If neither of these events occurs, the reserve account is used to make the final lease payment. Because the amount of the COP's proceeds that represents the Reserve for Debt Service may not legally be spent, this amount must be shown as nonspendable fund balance at year-end.

Underwriter's Discount—The fee a municipal underwriter charges to assume the underwriting risk of the COP. The underwriter's fees will typically be deducted from the proceeds before the proceeds are deposited with the trustee.

5. The trustee will maintain the proceeds in various trust accounts. The trustee will provide information to the LEA on all activity in the trust accounts. The LEA must account for all such activity in its books.

6. It is not necessary to make the lease payments for COPs from a separate debt service fund.

The following examples show the accounting for COPs in conformity with GAAP.

Assume that on August 1, 2024, a school district issues certificates of participation for the purchase of 123 school buses from the ABC Bus Company. The XYZ Bank is designated as trustee of the certificates and is assigned the right to enforce amounts payable by the district under the agreement. The first lease payment is due in February 2025, and the final payment is due in August 2029.

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Estimated Sources and Uses of Proceeds

Sources	**Amount**
Certificate Proceeds	$18,200,000
Accrued Interest	100,000
Total Sources	$18,300,000

Uses	**Amount**
Cost of Equipment	$14,950,000
Capitalized Interest	500,000
Reserve for Debt Service	2,700,000
Underwriter's Discount	150,000
Total Uses	$18,300,000

Assume that the Reserve for Debt Service of $2,700,000 was invested and estimated to earn interest of $110,000 through January 31, 2025, and $92,000 from February 1 through June 30, 2025.

The lease payment schedule is as follows:

Lease Payment Dates	**Principal Component**	**Interest Component**	**Total Payment**
February 1, 2025		$500,000	$500,000
August 1, 2025	3,200,000	500,000	3,700,000
February 1, 2026		400,000	400,000
August 1, 2026	3,300,000	400,000	3,700,000
February 1, 2027		300,000	300,000
August 1, 2027	3,500,000	300,000	3,800,000
February 1, 2028		200,000	200,000
August 1, 2028	3,800,000	200,000	4,000,000
February 1, 2029		100,000	100,000
August 1, 2029	4,400,000	100,000	4,500,000
Total	$18,200,000	$3,000,000	$21,200,000

Key Entries for Certificates of Participation

1. Proceeds from the sale of the certificates of participation (COPs) are deposited with the trustee in the name of the LEA. The terms of the COPs require a debt service reserve of $2,700,000. All interest earned on the debt service reserve is available for debt repayment.

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Date	Object Title	SACS Account String	Debit	Credit
8-1-24	Cash with a Fiscal Agent/Trustee	01-0000-0-0000-0000-9135	$18,150,000	
	Professional/Consulting Services and Operating Expenditures	01-0000-0-0000-9100-5800	150,000	
	Proceeds from COPs	01-0000-0-0000-0000-8971		$18,200,000
	Accounts Payable	01-0000-0-0000-0000-9500		100,000
	To record the receipt of the proceeds from the sale of the COPs to be used for the purchase of equipment and the underwriter's discount.			

2. Equipment is purchased.

Date	Object Title	SACS Account String	Debit	Credit
9-1-24	Equipment	01-0000-0-0000-3600-6400	$14,950,000	
	Cash in County Treasury	01-0000-0-0000-0000-9110		$14,950,000
	To record the purchase of 123 buses acquired through the issuance of COPs.			

3. Reimbursement is received from the trustee.

Date	Object Title	SACS Account String	Debit	Credit
11-1-24	Cash in County Treasury	01-0000-0-0000-0000-9110	$14,950,000	
	Cash with a Fiscal Agent/Trustee	01-0000-0-0000-0000-9135		$14,950,000
	To record the reimbursement received from the trustee.			

4. Interest is received on the investments of the $2,700,000 debt service reserve.

Date	Object Title	SACS Account String	Debit	Credit
2-1-25	Cash with a Fiscal Agent/Trustee	01-0000-0-0000-0000-9135	$110,000	
	Interest	01-0000-0-0000-0000-8660		$110,000
	To record the interest earned on the debt service reserve.			

5. The first lease payment, which represents interest only, is made in accordance with the lease payment schedule.

Date	Object Title	SACS Account String	Debit	Credit
2-1-25	Debt Service—Interest	01-0000-0-0000-9100-7438	$400,000	
	Accounts Payable	01-0000-0-0000-0000-9500	100,000	
	Cash with a Fiscal Agent/Trustee	01-0000-0-0000-0000-9135		$500,000
	To record the first payment on the COPs.			

6. Interest of $92,000 is earned, but not yet received, on the debt service reserve.

Date	Object Title	SACS Account String	Debit	Credit
6-1-25	Accounts Receivable	01-0000-0-0000-0000-9200	$92,000	
	Interest	01-0000-0-0000-0000-8660		$92,000
	To accrue interest earned on the investment of the debt service reserve.			

7. At the end of the fiscal year, the LEA reports nonspendable fund balance for the COP's required Reserve for Debt Service.

Date	Object Title	SACS Account String	Debit	Credit
6-30-25	Unassigned/ Unappropriated	01-0000-0-0000-0000-9790	$2,700,000	
	All Other Nonspendable Assets	01-0000-0-0000-0000-9719		$2,700,000
	To reflect the nonspendable portion of fund balance that represents the COP's required debt service reserve.			

8. The interest earned on the debt service reserve is received.

Date	Object Title	SACS Account String	Debit	Credit
7-5-25	Cash with a Fiscal Agent/Trustee	01-0000-0-0000-0000-9135	$92,000	
	Accounts Receivable	01-0000-0-0000-0000-9200		$92,000
	To record the receipt of interest earned on the debt service reserve through June 30.			

9. The second lease payment is made.

Date	Object Title	SACS Account String	Debit	Credit
8-1-25	Debt Service—Interest	01-0000-0-0000-9100-7438	$500,000	
	Other Debt Service—Principal	01-0000-0-0000-9100-7439	3,200,000	
	Cash in County Treasury	01-0000-0-0000-0000-9110		$3,498,000
	Cash with a Fiscal Agent/Trustee	01-0000-0-0000-0000-9135		202,000
	To record the second lease payment on the COPs.			