Post-Issuance Compliance: How to Live with a Bond Issue

By Donna L. Kreiser and Laura Cowburn

The Internal Revenue Service (IRS) has announced that post-issuance tax compliance is among its highest priorities. This is supported by the recently imposed annual reporting requirement on nonprofit corporations regarding the application and use of tax-exempt bonds issued for their benefit.

School districts issuing tax-exempt bonds often spend weeks or even months working toward the successful closing of a tax-exempt bond financing. The finance process includes, among other things, a detailed analysis by a bond counsel to ensure that the bonds will comply with federal tax law requirements.

Certain closing documents executed by school districts at the time of issuance of tax-exempt bonds include covenants by such issuers that tax law requirements will be complied with throughout the life of the bonds. And the opinion of the bond counsel rendered in connection with a tax-exempt bond issuance (opining that interest on the bonds is excluded from the gross income of bondholders) is based on, and qualified by, the school district's reasonable expectation that it will comply with the tax law requirements throughout the time the bonds remain outstanding.

In addition, school districts may be required to comply with certain disclosure requirements, or other reporting requirements as set forth in the bond finance documents, throughout the life of the bonds.

Because most tax-exempt bonds may remain outstanding for many years, and school districts must comply with federal tax laws, securities laws, and other document requirements during the life of the bonds, it is important to have procedures in place to ensure continued compliance, even as responsible officials change. An effective compliance program should help the school

district identify matters—tax or otherwise—that may require further analysis.

Post-issuance compliance programs may vary, depending on such factors as the number of bond issues to be monitored, the complexity of any financing, and the type of bond financing. Resources are available to help school districts develop a post-issuance compliance program. For instance, the National Association of Bond Lawyers and the Government Finance Officers Association have jointly developed a checklist to help identify post-issuance compliance matters. The checklist is available at www.gfoa.org/downloads/PostIssuanceCompliance.pdf. School districts may also seek guidance in preparing a post-issuance compliance program from bond counsel or their accounting firm.

Guidelines for Compliance

The following is a summary of topics to address in any post-issuance compliance program. It is not meant to serve as a complete list but rather should be considered a general guide, which may be refined for each school district. Keep in mind that any post-issuance compliance program must stay in place during the lifetime of each school district financing.

Designate a post-issuance compliance coordinator. First and foremost, each school district should designate a person or department to undertake responsibility for the post-issuance compliance program. The coordinator may be able to undertake all post-issuance compliance monitoring or may designate one or more people to undertake various components of the monitoring activity, as may be determined by such factors as the complexity of the financings being monitored. The coordinator should, among his or her various responsibilities, determine the frequency of review of post-issuance compliance matters.

Address post-issuance tax compliance. Any post-issuance compliance program must address appropriate record retention and include a plan for keeping relevant books and records regarding the investment and expenditure of bond proceeds. Further, the post-issuance compliance program must address arbitrage and the private use of bond proceeds. If the school district has issued Direct Payment BABs (Build American Bonds) or qualified school construction bonds, the post-issuance compliance program should address any specific requirements unique to these finance structures.

Address post-issuance disclosure requirements. Each school district should determine the applicability of continuing disclosure requirements with regard to the Security and Exchange Commission's Rule 15c2-12. A post-issuance compliance program should describe the nature and frequency of any continuing disclosure requirements, including the immediate reporting of the occurrence of any of the specific required reporting events listed in the continuing disclosure certificate or the discretionary reporting of other material events.

Rule 15c2-12 compliance is particularly important as the need for transparency and disclosure in the secondary market for tax-exempt bonds has recently been the subject of renewed focus by the Security and Exchange Commission. The commission recently proposed changes to the rule that would, among other things, add to the list of required disclosure events and impose new time limits for disclosure of required items.

Address other bond document requirements. The bond documents may include other reporting requirements or may set forth certain responsibilities to be undertaken by the school district. These reporting requirements may include providing audited financial statements or periodic certifications of insurance. Preparing a Comprehensive Annual Financial Report in compliance with ASBO International's Certificate of Excellence in Financial Reporting Program is one way to provide many of the general disclosures for financial and statistical purposes, and additional information could be added as needed.

Certain information may need to be filed with specific entities at specific times, such as paying agents or trustees, bond insurers, and credit enhancers. Further, the school district may be required to comply with rate covenants or other financial tests. A post-issuance compliance program should ensure the undertaking of all such reporting requirements or responsibilities.

Be Prepared

School districts should consider a board-approved post-issuance compliance policy. School districts that have effective post-issuance compliance programs in place will more likely be able to respond to an IRS inquiry on a successful and cost-effective basis. On the other hand, failure to undertake a post-issuance compliance program may place the school district at risk of violating tax rules, which could result in the loss of the tax-exempt status of the bonds, impose liability on the IRS or bondholders, and cause reputational damage. Violation of securities laws or existing document requirements could also expose any school district to unnecessary liability or potential bond document defaults.

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