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Chapter 2
Fund Accounting

TRUE/FALSE (CHAPTER 2)

1. Fund accounting promotes control and accountability over restricted resources.

2. The basis of accounting determines when transactions and events are recognized.

3. If an entity adopts a full accrual basis of accounting, its measurement focus will automatically be on cash.

4. A government may report some of its funds on a full accrual basis.

5. Funds divide a government into functional departments.

6. General funds are established to account for resources legally restricted for specified purposes.

7. Fiduciary activities are where governments act as trustee or custodians for individuals or entities other than itself.

8. The Financial Accounting Standards Board requires all nongovernmental not-for-profit entities to use fund accounting.

9. In addition to preparing fund financial statements, governments should also prepare consolidated financial statements to provide information on the financial position and operating results of the government as a single economic entity.

10. Fiduciary activities should be reported in fund statements and should be included in the consolidated government-wide statements.

11. At first glance, the government-wide statement of activities bears little resemblance to the income statement of a business.

12. In accounting for costs incurred on a major construction project in a capital projects fund, the construction outlays are reported as expenditures, not capital assets.

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ANSWERS TO TRUE/FALSE (CHAPTER 2)

1. True
2. True
3. False
4. True
5. False
6. False
7. True
8. False
9. True
10. False
11. True
12. True

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MULTIPLE CHOICE (CHAPTER 2)

1. What is the primary reason that governmental entities use fund accounting?
    a. Fund accounting is required by law.
    b. Fund accounting is required by GAAP.
    c. Fund accounting promotes control and accountability over restricted resources.
    d. Fund accounting promotes better control over operating activities.

2. Basis of accounting determines which of the following?
    a. When transactions and events are recognized.
    b. What transactions and events will be reported.
    c. Where transactions and events will be reported.
    d. Why transactions and events will be reported.

3. A fund is
    i. A separate legal entity.
    ii. A separate fiscal and accounting entity.

    a. I only
    b. II only
    c. I and II
    d. Neither I nor II

4. What type of fund is an investment trust fund?
    a. General fund.
    b. Proprietary fund.
    c. Fiduciary fund.
    d. Service fund.

5. When a governmental entity adopts a basis of accounting other than full accrual and a measurement focus that excludes long-lived assets and liabilities in its governmental fund types:
    a. It is in violation of the law.
    b. It is in violation of GAAP.
    c. It has reported in accordance with GAAP for governmental fund financial statements.
    d. It can better measure the results of operations.

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6. A city receives a donation from a citizen who specifies that the principal must be invested, and the earnings must be used to support operations of a city-owned recreational facility. The principal of this gift should be accounted for in which of the following funds?
    a. Trust fund.
    b. Special revenue fund.
    c. Permanent fund.
    d. Internal service fund.
7. Which of the following is NOT a governmental fund?
    a. City hall debt service fund.
    b. City utilities enterprise fund.
    c. Gasoline tax special revenue fund.
    d. City hall capital projects fund.

8. Which of the following accounts would you least expect to see in a debt service fund?
    a. Principal payments.
    b. Interest charges.
    c. Interest earned.
    d. Outstanding balance of the debt being serviced.

9. Which of the following funds is a proprietary fund?
    i. Internal service fund.
    ii. Enterprise fund.
    iii. Capital projects fund.
    a. I and II
    b. II and III
    c. I and III
    d. None of the above

10. Which of the following funds is a governmental fund?
    a. Enterprise fund.
    b. Debt service fund.
    c. Internal service fund.
    d. Custodial fund.

11. Deferred inflow of resources is
    a. Money that will be collected 5 years from now
    b. Money that is in a fiduciary fund until donor restrictions lapse
    c. Money collected in the current period that are applicable to the future periods
    d. Present obligations that the government has little or no discretion to avoid.

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12. Which of the following transactions should the City of Highland account for in a trust fund?
    a. General fund contributions received by the city pension plan.
    b. Greens fees received from golfers at the city-owned golf course.
    c. Grants received from the Federal government to purchase buses to be used for public transit.
    d. Proceeds of bonds issued to construct a new city hall building.

13. The state collects a gasoline tax that must be used to support highway construction and maintenance. The gasoline tax revenue should be accounted for in which of the following funds?
    a. General fund.
    b. Special revenue fund.
    c. Debt service fund.
    d. Internal service fund.

14. The City of San Jose built a new city hall and financed construction by issuing bonds due in installments over the next 30 years. The proceeds will be accounted for in which of the following funds?
    a. General fund.
    b. Internal service fund.
    c. Capital projects fund.
    d. Debt service fund.

15. Prepaid insurance is classified as
    a. Committed
    b. Restricted
    c. Assigned
    d. Non-spendable

16. To fulfill the printing needs of its various departments and agencies, the City has established a Central Print Shop, which bills the various departments and agencies of the city for printing services rendered. The Central Print Shop should be accounted for in which of the following funds.
    a. Internal service fund.
    b. Enterprise fund.
    c. General fund.
    d. Special revenue fund.

17. Which of the following sections is NOT required in the comprehensive annual financial report of a city?
    a. Financial section.
    b. Introductory section.
    c. Statistical section.
    d. Historical section.

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18. The basic financial statements of a city do NOT include which of the following?
    a. Government-wide statement of net position.
    b. Government-wide statement of activities.
    c. Government-wide statement of cash flows.
    d. Separate balance sheets for governmental and proprietary funds.

19. Which of the following funds is accounted for on the modified accrual basis of accounting?
    a. General fund.
    b. Internal service fund.
    c. Proprietary fund.
    d. Pension trust fund.

20. Which of the following assets would NOT be found in the general fund balance sheet of the City of Harrison?
    a. Cash.
    b. Capital assets.
    c. Due from special revenue fund.
    d. Due from state government.

21. Which of the following liabilities would NOT be found in the general fund balance sheet of the City of Marmaduke?
    a. Accounts payable.
    b. Due to special revenue fund.
    c. Deferred revenue.
    d. Bonds payable, due in 5 years.

22. For which of the following entities is fund accounting mandated for financial reporting?
    a. American Hospital Association.
    b. City of New York.
    c. Grace Lutheran Church.
    d. United Way.

23. The focus of the government-wide statement of activities of the City of West Hills is on which of the following?
    a. Determining the total expenses by natural classification.
    b. Determining the total expenses by function.
    c. Determining the total revenues by function.
    d. Determining the net cost of functions.

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24. Which of the following statements is NOT required in the financial reports of a not-for-profit entity?
    a. Statement of position.
    b. Statement of restricted funds.
    c. Statement of activities.
    d. Statement of cash flows.

25. FASB requires that not-for-profit entities classify net assets into the following
    i. Not Restricted
    ii. Restricted
    iii. Temporarily Restricted
    a. I and III
    b. II and III
    c. I and II
    d. I, II and III

26. Under the GASB Statement No. 34 reporting model, which of the following is required?
    a. Only one set of financial statements, prepared on the full accrual basis of accounting.
    b. Only one set of financial statements, prepared on the modified accrual basis of accounting.
    c. Two sets of financial statements, the general and proprietary fund statements prepared on the full accrual method and the government-wide on cash basis.
    d. Two sets of financial statements, the general fund statement on modified accrual, the proprietary fund and the government-wide statements on full accrual.

27. Under the GASB Statement No. 34 reporting model, the focus of the government-wide statement of activities is on which of the following?
    a. Program revenues and general revenues.
    b. Program revenues and expenses.
    c. Net income.
    d. The net cost of each of the government's main functions and programs.

28. A not-for-profit entity's statement of activities will report which of the following?
    a. Net assets as of the beginning of the year.
    b. Capital assets.
    c. Temporarily restricted net assets.
    d. Permanently restricted net assets.

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29. Which of the following funds of Chessie City would be consolidated to form the governmental activities column in the city's government-wide financial statements?
    a. General fund, special revenue fund, and agency fund.
    b. General fund, debt service fund, and capital projects fund.
    c. General fund, enterprise fund, and fiduciary fund.
    d. Enterprise fund and internal service fund.

30. Which fund type would all governments normally include in their fund financial statements?
    a. Capital projects funds
    b. Special revenue funds
    c. General fund
    d. Fiduciary funds

31. Under the GASB Statement No. 34 reporting model, fund financial statements include separate sets of financial statements for:
    a. Each major function of the government.
    b. Governmental funds, proprietary funds, and fiduciary funds.
    c. Governmental funds, enterprise funds, and internal service funds.
    d. Governmental funds, special revenue funds, and debt service funds.

32. When a fax machine purchased by a governmental entity is received, it should be recorded in the general fund as a(n)
    a. Expense
    b. Encumbrance
    c. Expenditure
    d. Extravagance

33. Which of the following is NOT included in the financial section of a comprehensive annual financial report?
    a. Required supplementary information
    b. Letter of transmittal
    c. Financial statements
    d. Notes to the statements

34. During the current fiscal year, Mountain View City's water utility, an enterprise fund, rendered billings for water supplied to the general fund. Which of the following accounts should be debited by the general fund?
    a. Transfer-out to enterprise fund
    b. Due to water utility enterprise fund
    c. Appropriations
    d. Expenditures

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35. Lakeside Art Center, a nongovernmental not-for-profit entity, receives a contribution of $5 million. The donor stipulates that the contribution must be used to acquire paintings by local artists. Lakeside should classify the contribution as
    a. Not restricted
    b. Restricted
    c. Committed
    d. Assigned

36. Wigmore City receives a donation of $10 million from a wealthy citizen who stipulates that the funds be used to acquire and install park benches in the city's Veterans Park. The city should report the donation as an increase in
    a. Unassigned fund balance
    b. Assigned fund balance
    c. Committed fund balance
    d. Restricted fund balance

37. The accounting equation applied by state and local governments is
    a. Assets + deferred inflows of resources - liabilities = fund balance
    b. Assets + deferred outflows of resources - liabilities - deferred inflows of resources = fund balance
    c. Assets + deferred inflows of resources = liabilities + deferred outflows of resources + fund balance
    d. Assets - deferred outflows of resources - liabilities + deferred inflows of resources = fund balance

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ANSWERS TO MULTIPLE CHOICE (CHAPTER 2)

1. c
2. a
3. b
4. c
5. c
6. c
7. b
8. d
9. a
10. b
11. c
12. a
13. b
14. d
15. b
16. a
17. d
18. c
19. a
20. b
21. d
22. b
23. d
24. b
25. d
26. d
27. a
28. d
29. a
30. b
31. c
32. b
33. c
34. b
35. d
36. b
37. d
38. b

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PROBLEMS (CHAPTER 2)

1. Assume that the City of Fort Smith maintains its books and records in a manner that facilitates the preparation of fund financial statements. For each of the following events indicate in which fund(s) of the city the event would be recorded and justify your fund selection.

   a. The city collected property taxes levied for the general operations of the city.
   b. The city collected property taxes levied to pay principal and interest on bonds issued several years in the past to construct a new fire station.
   c. The city collected property taxes levied on a specific area of the city for the purposes of providing more frequent snow removal than is enjoyed by the rest of the city.
   d. The city sold bonds to finance the construction of a new city hall.
   e. The city sold bonds to finance major renovations at the city-owned electric utility.
   f. The city purchased a street sweeping machine.

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2. Assume that the City of Amber maintains its books and records in a manner that facilitates the preparation of fund financial statements. Amber City maintains a general fund, a capital projects fund, and a special revenue fund. During the current fiscal year, the city engaged in the following transactions. Record all transactions. Be sure to indicate clearly the fund in which the entry is made.

   a. The city sold bonds, face value $26 million, at par to finance the construction of a new city hall.
   b. The city purchased two new police cars at a total cost of $50,000.
   c. The city collected $8,000 in taxes dedicated for the eradication of noxious weeds.
   d. The city spent $6,000 on pesticides for noxious weeds.
   e. The city acquired a new tractor for $80,000. The city paid $20,000 in cash and signed a note that is due in three years.

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3. Assume that Blackfoot County maintains its books and records in a manner that facilitates the preparation of fund financial statements. The county engaged in the following transactions during the current month. Prepare journal entries in the general fund to record these events.

   a. Paid salaries to county employees, $100,000.
   b. Borrowed $35,000 on a three-year note from a local bank to buy a county car.
   c. Purchased the county car for $35,000.
   d. Made a $7,000 payment on outstanding accounts payable.
   e. Collected $3,500,000 of the current property tax levy.
   f. Received a $50,000 grant from the State to support general government activities.

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4. Kayla Township issued the following bonds during the year:
   - Ten-year bonds to acquire equipment for a data processing service reported in an internal service fund $2,000,000
   - Bonds to construct a new police station $9,000,000
   - Bonds to increase the capacity of the water treatment plant reported in an enterprise fund $4,800,000

   a. The amount of debt reported in the Township's general fund is:
      1. $0
      2. $9,000,000
      3. $11,000,000
      4. $15,800,000

   b. The township should report depreciation expense on related new capital assets in:
      1. General fund
      2. Enterprise fund
      3. Enterprise and internal service funds
      4. Capital projects fund

   c. The bonds issued to construct the new police station should be reported as:
      1. Debt proceeds in the general fund
      2. Long-term debt in a debt service fund
      3. Debt proceeds in a capital projects fund
      4. None of the above

   d. In accordance with bond covenants the township sets aside $1,000,000 to help ensure that it is able to meet its first payment of principal and interest on the police station debt due one year from the date the bonds were issued. The amount of liability that the township should report in its debt service fund is:
      1. $0
      2. $1,000,000
      3. $9,000,000
      4. $8,000,000

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5. The Chessie Foundation, a newly established governmental entity, engaged in the following transactions:

- A donor made a $1,000,000 pledge, giving the foundation a legally enforceable 90-day note for the full amount.
- The same donor paid $500,000 of the amount pledged.
- The foundation purchased a building for $900,000, paying $90,000 in cash and giving a ten-year mortgage for the balance. The building has a 25-year useful life. The foundation charges a half-year's depreciation for all assets in the year they are acquired.
- The foundation hired five employees. By year-end, these employees have earned $10,000 in salaries and wages for which they have not been paid.

The foundation accounts for its activities in a single fund.

a. Prepare journal entries to record the transactions, making the following alternative assumptions as to the fund's measurement focus:

- Cash only
- Cash plus other current financial resources (cash plus short-term receivables less short-term payables)
- All economic resources

b. Based on your entries, prepare appropriate operating statements and balance sheets for the organization.

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6. Katerah City maintains the following funds:

   - General
   - Special revenue
   - Capital projects
   - Debt service
   - Enterprise
   - Investment trust
   - Permanent
   - Agency

   For each of the following transactions, indicate which fund would most likely be used to report the transaction:

a. The city collects $1 million of taxes for an independent fire district located within the city.
b. The city spends $1.2 million on street maintenance using the proceeds of a city gas tax dedicated for road and highway maintenance and improvements.
c. The city receives a bequest of $1.5 million. The donor's will, requires that the principal amount be invested in perpetuity and that the earnings on the investment be used to maintain a city park to be renamed for the donor.
d. The city collects water and sewer fees of $4.2 million.
e. The city pays $4 million to a contractor for work on a new bridge.
f. The city receives $1.3 million to invest on behalf of the county.
g. The city pays its police officers wages of $325,000.
h. The city pays $2.2 million in bond interest on its general obligation debt.

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7. The Geneva Housing Authority, a governmental entity, accounts for its activities on a modified accrual basis of accounting. In the current period, it reports the following transactions:

- The Authority issued $2.5 million in long-term bonds.
- The Authority purchased 4 acres of land for $500,000 in cash.
- It sold one of the 4 acres of land for $125,000 in cash.
- It made a $325,000 payment on the debt, consisting of $75,000 of interest and $250,000 of principal.
- It lost a lawsuit filed by one of its renters and was ordered to pay $1 million in damages over 5 years. It made its first cash payment of $200,000.

a. Prepare journal entries to record each of these transactions in the general fund.
b. Based on your entries, prepare a balance sheet and statement of revenues, expenditures, and changes in fund balance for the general fund.
c. Comment on how these statements capture the Authority's economic resources and obligations.
d. Comment on the extent to which the statement of revenues, expenditures, and changes in fund balances captures the Authority's costs of services.
e. When the Authority prepares GAAP financial statements based on GASB Statement No. 34, what assets and liabilities would be added in the Authority's government-wide Statement of Net Assets? What gains and losses would be added in its government-wide Statement of Activities?

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8. The newly established Environmental Council (a nongovernmental not-for-profit organization) uses two funds for internal reporting purposes. The general fund is used to record day-to-day operating transactions. A building fund is used to accumulate resources for a new building to house the Council's operations. Both funds are reported using the accrual basis of accounting. In its first year, the Council engaged in the following transactions:

- It received cash contributions of $500,000. Donors stipulate that $100,000 of this amount must be used for the new building.
- It incurred operating payroll costs of $200,000, of which $180,000 is paid in cash.
- It earned $1,000 in interest (paid in cash) on investments restricted to the acquisition of the new building.
- It transferred $25,000 from its general fund to the building fund.
- It paid $15,000 in fees (accounted for as expenses) for architectural drawings for the proposed building.

a. Prepare journal entries to record the transactions. Be sure to indicate the fund in which the entry would be made.
b. Prepare a statement of revenues, expenses, and other changes in fund balances and a balance sheet. Use a two-column format, one column for each of the Council's two funds.

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ANSWERS TO PROBLEMS (CHAPTER 2)

Problem 1

a. General fund. The general fund is used to account for the general activities of a governmental entity.
b. Debt service fund. The debt service fund is used to account for payments of principal and interest on debt incurred to finance general government activities.
c. Special revenue fund. The proceeds may only be used for snow removal. By accounting for the proceeds and for the expenditure of the proceeds in a special revenue fund the entity can demonstrate that it used the resources for the required purpose.
d. Capital projects fund. A new city hall is a general government asset. The capital projects fund is used to account for the resources held for the purpose of construction and/or acquisition of major capital facilities. It is also used to account for expenditures for the construction and/or acquisition of those assets.
e. Enterprise fund. Normally, governments use enterprise funds to account for activities for which there are comparable activities in the private sector. If the electric utility is accounted for in an enterprise fund, all capital assets and all long-term debt associated with those activities will be accounted for in the enterprise fund.
f. General fund. The general fund is used to account for the general activities of a government. However, only the expenditure for the machine would be reported in this fund. The machine (a capital asset) is reported only in the government-wide financial statements.

Problem 2

a.	CAPITAL PROJECTS FUND		
	Cash	$26 million	
	Proceeds from borrowing		$26 million
b.	GENERAL FUND		
	Vehicle expenditure	$ 50,000	
	Cash		$ 50,000
c.	SPECIAL REVENUE FUND		
	Cash	$ 8,000	
	Tax revenue		$ 8,000
d.	SPECIAL REVENUE FUND		
	Expenditures for weeds	$ 6,000	
	Cash		$ 6,000

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e. GENERAL FUND

Tractor expenditure	$80,000	
Proceeds of note		$ 60,000
Cash		20,000

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Problem 3

a.	Expenditures-salaries	$100,000	
	Cash		$100,000
b.	Cash	$ 35,000	
	Proceeds of notes		$ 35,000
c.	Automobile expenditure	$ 35,000	
	Cash		$ 35,000
d.	Accounts payable	$ 7,000	
	Cash		$ 7,000
e.	Cash	$3,500,000	
	Property tax revenue $3,500,000		
f.	Cash	$ 50,000	
	Grant revenue		$ 50,000

Problem 4

a. 1
b. 3
c. 3
d. 1

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Problem 5

a. Focus on cash

(1)

No entry necessary — no cash involved.

(2)

Cash	$ 500,000	
Contribution revenues		$ 500,000

To record the partial collection of the note

(3)

Building acquisition expenditure	$ 90,000	
Cash		$ 90,000

To record the cash paid to acquire the building

(4)

No entry necessary — no cash involved

Focus on cash plus current financial resources

(1)

Note receivable	$1,000,000	
Contribution revenue		$1,000,000

To record the note received

(2)

Cash		$ 500,000
Note receivable		$ 500,000

To record the partial collection of the note

(3)

Building acquisition expenditure	$ 90,000	
Cash		$ 90,000

To record the cash paid to acquire the building (No recognition is given to the long-term note or to the building, a long-term asset.)

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(4)

Wage expenditure	$ 10,000	
Wages payable		$ 10,000

To record the wages earned by employees, but not yet paid.

Focus on all economic resources

(1)

Note receivable	$1,000,000	
Contribution revenue		$1,000,000

To record the note received

(2)

Cash	$ 500,000	
Note receivable		$ 500,000

To record the partial collection of the note

(3)

Building	$ 900,000	
Cash		$ 90,000
Mortgage note payable		810,000

To record the acquisition of the building

Depreciation expense	$ 18,000	
Accumulated depreciation		$ 18,000

To record depreciation on the building

(4)

Wage expense	$ 10,000	
Wages payable		$ 10,000

To record the wages earned by employees, but not yet paid

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b.

Statements of Revenues and Expenditures

	Cash	Current Financial Resources	All Economic Resources
Contribution revenue	$500,000	$1,000,000	$1,000,000
Building acquisition expenditure (or depreciation expense)	90,000	90,000	$ 18,000
Wage expenditure/expense	0	10,000	10,000
Total expenditures/expenses	90,000	100,000	28,000
Excess of revenues over expenditures/expenses	$410,000	$ 900,000	$ 972,000

Balance Sheets

	Cash	Current Financial Resources	All Economic Resources
Assets			
Cash	$410,000	$ 410,000	$ 410,000
Note receivable		500,000	500,000
Building (less accumulated depreciation)			882,000
Total assets	$410,000	$ 910,000	$1,792,000
Liabilities and Fund Balance			
Wages payable		$ 10,000	$ 10,000
Mortgage note payable			810,000
Fund balance	410,000	900,000	972,000
Total liabilities and fund balance	$410,000	$ 910,000	$1,792,000

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Problem 6

a. 8
b. 2
c. 7
d. 5
e. 3
f. 6
g. 1
h. 4

Problem 7

1. Journal entries in Authority's general fund

(1)

Cash	$2,500,000	
Proceeds from borrowing		$2,500,000
To record the issuance of bonds		

(2)

Expenditure for land	$ 500,000	
Cash		$ 500,000
To record the purchase of land		

(3)

Cash	$ 125,000	
Proceeds from sale of land		$ 125,000
To record sale of land		

(4)

Repayment of bonds (expenditure)	$ 325,000	
Cash		$ 325,000
To record repayment of bonds		

(5)

Legal claims (expenditure)	$ 200,000	
Cash		$ 200,000
To record payment of judgment		

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2. Modified accrual statements

Geneva Housing Authority
General Fund Balance Sheet

Cash	$1.600,000
Fund Balance	$1,600,000

Geneva Housing Authority
General Fund Statement of Revenues, Expenditures, and Changes in Fund Balance

Revenues and other financing sources	
Bond proceeds	$2,500,000
Proceeds from sale of land	125,000
Total revenues and other financing sources	$2,625,000
Expenditures and other financing uses	
Repayment of bonds	$325,000
Acquisition of land	500,000
Legal claims	200,000
Total expenditures and other financing uses	$1,025,000
Excess of revenues and other financing sources over expenditures and other financing uses	$1,600,000

3. The general fund balance is not intended to report economic resources. Rather it reports current financial resources—current financial resources available to meet current obligations. Only the government-wide statements measure all economic resources—including capital assets and long-term obligations.

4. The general fund statement of revenues, expenditures and other financing sources does not measure the cost of services (e.g., it recognizes borrowings as an increase in fund balance and the full cost of acquiring capital assets as a decrease in fund balance). It is not designed to do so. Instead it is designed to report on flows of current financial resources.

5. In its GAAP government-wide Statement of Net Position, the Authority would report its capital assets (land) and long-term liabilities (long-term debt and claims and judgments). In the Statement of Activities, the Authority would report a gain on the sale of land and a loss related to the renter's lawsuit. The government-wide statements are prepared using the accrual basis of accounting and therefore measure all economic resources, not just current financial resources.

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Problem 8

a. Journal entries

(1)

Cash	$400,000	
Contribution revenues		$400,000
To record contribution revenue (general fund)		

Cash	$100,000	
Contribution revenues		$100,000
To record contribution revenue (building fund)		

(2)

Operating expenditures	$200,000	
Cash		$180,000
Salaries payable		20,000
To record payroll expenditures (general fund)		

(3)

Cash	$ 1,000	
Interest revenue		$ 1,000
To record interest revenue (building fund)		

(4)

Transfer-out to building fund	$ 25,000	
Cash		$ 25,000
To record transfer-out to building fund (general fund)		

Cash	$ 25,000	
Transfer-in from general fund		$ 25,000
To record transfer-in from general fund (building fund)		

(5)

Expenses for architectural services	$ 15,000	
Cash		$ 15,000
To record fees paid to architect (building fund)		

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b. Financial Statements

Environmental Council
Statement of Revenues, Expenses, and Other Changes in Fund Balances

	General Fund	Building Fund
Revenues		
Contribution revenue	$400,000	$100,000
Interest		1,000
Total revenues	400,000	101,000
Expenditures		
Operating expenditures	200,000	
Architecture services		15,000
Excess of revenues over expenses	200,000	86,000
Transfers from (to) other funds	(25,000)	25,000
Increase in fund balance	$175,000	$ 111,000

Environmental Council
Balance Sheet

	General Fund	Building Fund
Assets		
Cash	$ 195,000	$111,000
Liabilities and fund balance		
Salaries payable	$ 20,000	
Fund balance	175,000	$111,000
Total liabilities and fund balance	$195,000	$111,000

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ESSAYS (CHAPTER 2)

1. Why do governments and not-for-profit entities use fund accounting?

2. Governments use the modified accrual basis of accounting and a current financial resources measurement focus when presenting the governmental fund financial statements but they use the accrual basis of accounting and the flow of economic resources for the government-wide financial statements. What is a basis of accounting? What is measurement focus? How does the selection of one affect the selection of the other?

3. For what purposes do governmental entities use agency funds? What are the distinguishing characteristics of agency funds?

4. The basic financial statements for Ammon City contain the following statements. For each statement identify the appropriate measurement focus and basis of accounting.

   a.) Government-wide statement of position
   b.) Government-wide statement of activities
   c.) Balance sheet—governmental funds
   d.) Statement of revenues, expenditures, and changes in fund balance—governmental funds
   e.) Statement of net assets—proprietary funds
   f.) Statement of revenues, expenses, and changes in fund net assets—proprietary funds

5. The activities of an internal service fund are presented on the statement of revenues, expenses, and changes in fund net assets in the fund financial statements. Why?

6. What are the three categories of restrictions that must be used to report the resources of not-for-profit organizations? Who must impose the restrictions in order for them to be reported?

7. Why is long-term debt generally **not** reported in a government's debt service funds?

8. What are fiduciary funds? Why don't governments incorporate (consolidate) these funds into their government-wide financial statements?

9. The City of Orlando maintains funds for debt service, capital projects, and special revenues. It does not, however, maintain funds for police, recreation, and general administration. Why do you suppose it does not maintain a separate fund for each of its functional areas?

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10. GASB Statement No. 34 mandates that the government reconcile total governmental fund balances per the fund balance sheet with net assets of governmental activities per the government-wide statements. What are likely to be the two largest reconciling items for most major cities? Why?

11. What are the elements of the financial statements of state and local governments? Which elements relate to statements of net position? How do these elements differ from those reported by businesses?

12. Compare a *restricted* fund balance with a *committed* fund balance. Give an example of when a government might use each classification.

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ANSWERS TO ESSAYS (CHAPTER 2)

1. Government and not-for-profit entities use fund accounting to demonstrate accountability. By segregating the assets, entities are able to demonstrate clearly that the assets were used for the intended purposes. By segregating certain activities, governments can better control the revenues and expenditures/expenses of these activities. It would not be uncommon for governments and not-for-profit entities to segregate assets whose use is restricted by outside donors, nor would it be uncommon for these entities to segregate the revenues and expenses of activities that are supposed to be self-supporting.

2. Basis of accounting determines WHEN transactions and events are recognized. Measurement focus determines WHAT is being reported upon. If an entity selects the cash basis of accounting, its measurement focus will necessarily be upon the flow of cash. If an entity selects full accrual accounting its measurement focus will, of course, be upon flow of economic resources, including noncurrent as well as current resources. An entity must decide WHAT assets and liabilities it wants to display (e.g., cash, current financial resources, or all economic resources) and choose a basis of accounting that will enable the entity to display those assets and liabilities.

3. Agency funds are used to account for assets that a government holds temporarily on behalf of other governments, private organizations, or individuals. Agency funds are mechanisms for segregating, on financial reports, assets held for others, to demonstrate accountability and stewardship. Because agency funds are merely lists of assets held for others, with a corresponding obligation to those parties, agency funds have no operating accounts and no equity accounts. The accounting equation is assets = liabilities.

4. a.) Economic resources; accrual
   b.) Economic resources; accrual
   c.) Current financial resources; modified accrual
   d.) Current financial resources; modified accrual
   e.) Economic resources; accrual
   f.) Economic resources; accrual

5. The activities of an internal service fund are presented on the statement of revenues, expenses, and changes in fund net assets because they are part of the proprietary fund category. Proprietary funds are reported using the economic resources measurement focus and the accrual basis of accounting to provide information about the full cost of the activities reported in those funds.

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6. Temporarily restricted, permanently restricted, and unrestricted resources. Temporarily restricted resources are those that must be used for a specific purpose (for example, to support donor-designated programs or activities) or cannot be spent until some time in the future (for example, when a donor makes good on a pledge). Permanently restricted resources are typically endowments, only the income from which can be spent. Unrestricted funds, of course, are not subject to restrictions. The restrictions are based only on donor mandates. Restrictions imposed by other parties (for example, creditors) are not taken into account for purposes of resource classification.

7. Generally long-term debt is not reported in the debt service fund because these funds are maintained on the modified accrual basis of accounting to account only for the current financial resources that will be used to pay the interest and principal on long-term debt. These resources are set apart from other resources because they can only be used for their specified purposes. The principal and interest payments on the long-term debt that are currently due and payable are reported in the debt service fund that will service the long-term debt.

8. Fiduciary funds are used to account for resources held by the government as either a trustee (a party that administers property for a beneficiary) or an agent (one who acts on behalf of another). Governments do not incorporate (consolidate) fiduciary funds into their government-wide financial statements because they benefit only outsiders and a government cannot expect to have use of their resources.

2. Funds are not maintained for organizational units. They are established only for resources that are restricted. Typically the resources for the key functional areas are provided by unrestricted tax revenues.

3. Long-lived assets and long-term liabilities. These are recorded on the government-wide statements but not the fund statements as the former are on a full accrual basis but the latter are on a modified accrual basis.

4. The elements of the financial statements of state and local governments are: assets, liabilities, outflows of resources, inflows of resources, deferred outflows of resources, deferred inflows of resources, and net position. Acceptable formats for reporting the elements relating to statements of net position are: Assets + deferred outflows of resources = liabilities + deferred inflows of resources + net position (or fund balance) or alternatively, Assets + deferred outflows of resources – liabilities – deferred inflows of resources = net position (or fund balance). Thus, deferred outflows and inflows of resources are reported in separate categories from assets and liabilities. In contrast, businesses generally use the reporting format: assets – liabilities = owners' equity. Although businesses do distinguish deferred resource flows, such as deferred revenues and deferred costs, from current resources flows,

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they report deferred resources flows among, respectively, liabilities and assets rather than in separate categories.

5. For a fund balance to be *restricted*, the constraints on the use of resources must be imposed by parties *external* to the government, such as creditors, bondholders, or grant providers, or through constitutional provisions, enabling legislation, or laws or regulations of other governments. For example, a federal agency provides grants to a state government for use only to enhance state highway patrol activities. In this case, fund balance should be restricted because the constraint is imposed by a party (federal agency) that is external to the state government. Restrictions on resources may only be changed or removed with the consent of the providers.

   In contrast, *committed* fund balances comprise resources that must be used for specific purposes based on constraints imposed by formal action of the government's own highest level of decision-making authority. For example, the governing body of a state college commits resources to improve the provision of student health services. In this case the constraint is imposed by the government's own highest-level authority, not by a party external to the government. The constraints governing commitments can only be changed or removed by the same formal action that originally imposed them.

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