

Chapter 2

The Use of Funds in Governmental Accounting

Learning Objectives – Coverage by Question				
	True / False	Multiple Choice	Exercises	Problems
LO1 – Understand the nature of fund accounting; identify the three fund categories; describe accounting measurements in each category.	1-4	1-8, 28		
LO2 – Describe purpose of each governmental fund type; gain overview of governmental fund accounting and financial reporting.	5-18, 24	8-34	1-3	1
LO3 – Describe purpose of each proprietary fund type; get overview of proprietary fund accounting and financial reporting.	19-24	33-44	1-3	1
LO4 – Describe purpose of each fiduciary fund type; get overview of fiduciary fund accounting and financial reporting.	25-27	44-51	3	

Chapter 2: The Use of Funds in Governmental Accounting

True / False

Topic: Measurement Focus and Basis of Accounting

LO: 1

1. Basis of accounting refers to the timing of the recognition of assets, liabilities, revenues and expenses or expenditures. The basis of accounting facilitates what one is trying to measure.

Answer: True

Rationale: The basis of accounting is a timing concept that deals *when* assets, liabilities, revenues, and expenses (or expenditures) are recognized.

Topic: Measurement Focus and Basis of Accounting

LO: 1

2. To determine whether they have obtained sufficient revenues to cover their expenses, funds that account for governmental business-type activities use the modified accrual basis of accounting.

Answer: False

Rationale: The full accrual basis of accounting must be used to determine if revenues cover expenses.

Topic: Measurement Focus and Basis of Accounting

LO: 1

3. Depreciation of capital assets is not recognized as an expense in a Special Revenue Fund, but it is recognized as an expense in an Internal Service Fund.

Answer: True

Rationale: Special Revenue Funds use the current financial resources measurement focus and modified accrual basis of accounting. Capital assets are reported as expenditures when they are acquired. No depreciation expense is recorded. Internal Service Funds use the economic resources measurement focus and accrual basis of accounting. Expenses are recognized when assets are consumed (or costs have expired). Therefore, depreciation expense is recognized as capital assets are consumed.

Topic: Measurement Focus and Basis of Accounting

LO: 1

4. Governmental-type funds use the current financial resources measurement focus and the modified accrual basis of accounting.

Answer: True

Rationale: Governmental-type funds use the current financial resources measurement focus and modified accrual basis of accounting. This measurement focus and basis of accounting provides information about the financial resources that are available for spending.

Topic: Measurement Focus and Basis of Accounting

LO: 2

5. Revenue is recognized in governmental-type funds when it is earned.

Answer: False

Rationale: Revenue must also be measurable and available to be recognized.

Topic: Measurement Focus and Basis of Accounting

LO: 2

6. Property taxes are recognized as revenues in governmental type funds to the extent that they are collected in the year for which they are levied.

Answer: False

Rationale: In governmental type funds, revenues are recognized when they are measurable and available. "Available" includes not only revenues that are collected in the year for which the taxes have been levied, but also collected soon enough (usually 60 days) after the accounting period to be used to pay the bills of the period.

Topic: Measurement Focus and Basis of Accounting

LO: 2

7. Under the modified accrual basis of accounting, expenditures are generally recognized in the period that goods and services are received, but there are a number of exceptions to that rule.

Answer: True

Rationale: Expenditures generally are recognized in the period goods or services are received. Some expenditures, such as those related to employee vacation leave that is paid upon retirement, are not recognized until the employee retires—that is, when the liability matures.

Topic: Governmental-Type Funds

LO: 2

8. All funds report both financial assets and capital assets.

Answer: False

Rationale: Governmental-type funds report only financial assets. Enterprise and Fiduciary type funds report both financial and capital assets.

Topic: Governmental-Type Funds

LO: 2

9. Assets of governmental-type funds include cash and investments, but not capital assets.

Answer: True

Rationale: Governmental-type funds report only financial assets, which includes cash and investments, but not capital assets.

Topic: General Fund

LO: 2

10. All general-purpose governments use a General Fund.

Answer: True

Rationale: The General fund is used to account for and report financial resources not accounted for in some other fund. General-purpose governments, such as city, county, and state governments, generally account for most of their activities in the General Fund.

Topic: General Fund

LO: 2

11. For financial reporting purposes, operating transfers from the General Fund to another fund are generally reported in a separate section of the operating statements for each of the funds.

Answer: True

Rationale: Transfers in and out of funds are reported in a separate section of the operating statement entitled, "Other financing sources (uses)."

Topic: General Fund and Capital Projects Funds

LO: 2

12. Long-term liabilities resulting from the *operating activities* of a General Fund, such as accrued vacation leave, are reported in the fund-level financial statements. Long-term liabilities resulting from the *capital acquisition activities* of a Capital Projects Fund, however, are not.

Answer: False

Rationale: Long-term liabilities related to both General Fund and Capital Projects Fund activities are not reported in the fund-level financial statements. All such debt is reported only in the government-wide financial statements, regardless of its purpose.

Topic: Special Revenue Funds

LO: 2

13. Special Revenue Funds are used to account for specific revenue sources that are restricted or committed to spending for specific operating purposes, debt service, or capital projects.

Answer: False

Rationale: Special Revenue Funds are used to account for specific revenue sources that are restricted or committed for spending for specified purposes *other than* on debt service or capital projects.

Topic: Capital Projects Funds

LO: 2

14. Likely sources of funding major capital projects are proceeds from long-term borrowing, intergovernmental grants, and transfers from other funds.

Answer: True

Rationale: Long-term borrowing, intergovernmental grants, and transfers from other funds are often sources of financing for major capital projects.

Topic: Capital Projects Funds

LO: 2

15. Long-term borrowing is a source of financing capital acquisitions, but the borrowing is not reported as a liability of the Capital Projects Fund.

Answer: True

Rationale: Long-term liabilities are not reported in governmental-type funds including the Capital Projects Fund.

Topic: Capital Projects Funds

LO: 2

16. Capital assets are reported in the assets section of the Capital Projects Fund balance sheet.

Answer: False

Rationale: Capital Projects Funds only report financial resources, not capital resources. Outlays for capital assets are treated as expenditures, not as assets.

Topic: Capital Projects Funds

LO: 2

17. Capital asset acquisitions are always financed with Capital Projects Fund resources.

Answer: False

Rationale: There is nothing to preclude the financing of capital assets with tax resources from the General Fund.

Topic: Debt Service Funds

LO: 2

18. It is not possible for expenditures of a Debt Service Fund to exceed revenues in a particular year.

Answer: False

Rationale: Transfers from other funds (often the General Fund) are a major source of resources for the Debt Service Fund. Transfers in from other funds are accounted for as other financing sources instead of revenues. Therefore, expenditures often exceed the revenues of a Debt Service Fund for a particular year. Also, a Debt Service Fund may have beginning fund balance, which can be used for expenditures during the year.

Topic: Enterprise Funds

LO: 3

19. Enterprise Funds provide services primarily to governmental departments and agencies.

Answer: False

Rationale: Enterprise Funds provide services primarily to the general public.

Topic: Enterprise Funds

LO: 3

20. Enterprise Funds are financed to some degree through charges to external users.

Answer: True

Rationale: Enterprise Funds may be used to account for any activity whose products or services are sold for a fee to external users.

Topic: Enterprise Funds

LO: 3

21. For financial reporting, current assets and liabilities are separated from noncurrent assets and liabilities in the balance sheets of Enterprise Funds.

Answer: True

Rationale: Financial statements for proprietary funds present current assets before noncurrent assets and current liabilities before noncurrent liabilities.

Topic: Enterprise Funds and Internal Service Funds

LO: 3

22. Enterprise Funds use a different basis of accounting than Internal Service Funds.

Answer: False

Rationale: Both Enterprise Funds and Internal Service Funds use the full accrual basis of accounting.

Topic: Enterprise Funds and Internal Service Funds

LO: 3

23. As a general rule, Internal Service Funds sell goods and services to governmental agencies, and Enterprise Funds sell goods and services to the general public. This means an Enterprise Fund cannot sell some goods and services to the government itself.

Answer: False

Rationale: Enterprise Funds, particularly utilities, may also sell goods and services to the government itself, but those sales should represent only a small part of total enterprise fund revenues.

Topic: Measurement Focus and Basis of Accounting

LO: 2, 3

24. All the long-term debt of a government, including the long-term debt that will be financed by Enterprise Fund revenues, is reported in the fund-level financial statements.

Answer: False

Rationale: Enterprise Fund long-term debt is reported in the fund financial statements, but general long-term debt is not. General long-term debt is reported only in the government-wide statements.

Topic: Fiduciary Type Funds

LO: 4

25. Pension Trust Funds use the modified accrual basis of accounting.

Answer: False

Rationale: Fiduciary-type funds, which include Pension Trust Funds, use the accrual basis of accounting.

Topic: Fiduciary Type Funds

LO: 4

26. The external portion of an investment pool should be reported in a fiduciary type fund.

Answer: True

Rationale: The external portion of an investment pool is accounted in an Investment Trust Fund, which is a fiduciary type fund.

Topic: Fiduciary Type Funds

LO: 4

27. The required financial statements for fiduciary type funds are a statement of changes in fiduciary net position and a statement of fiduciary net position.

Answer: True

Rationale: The aforementioned statements are the only required financial statements for fiduciary type funds.

Multiple Choice

Topic: Measurement Focus and Basis of Accounting

LO: 1

1. To what does *basis of accounting* refer?
 - a. Whether an entity is trying to measure the excess of inflows over outflows
 - b. How much cash an entity received in a particular reporting period
 - c. The timing of recognition of assets, liabilities, revenues, and expenditures/expenses in financial statements
 - d. The ownership of the assets, liabilities, and equities reported in a balance sheet

Answer: C

Rationale: Basis of accounting deals with the timing or when assets, liabilities, revenues, and expenditures/expenses are recognized.

Topic: Fund Accounting

LO: 1

2. Governmental accounting normally
 - a. Uses separate funds to account for various activities
 - b. Uses the accrual basis of accounting
 - c. Measures the amount of profit earned during a fiscal year
 - d. Focuses on cash flows

Answer: A

Rationale: A distinguishing feature of governmental accounting is the use of funds. The modified accrual basis of accounting is used for governmental-type funds and the accrual basis of accounting is used for proprietary type and fiduciary type funds.

Topic: Fund Accounting

LO: 1

3. In governmental accounting, a fund is best defined as:
 - a. A sum of cash set aside to attain certain objectives
 - b. A fiscal entity that has both financial and capital resources
 - c. A fiscal entity that has cash resources only
 - d. A fiscal and accounting entity with a self-balancing set of accounts

Answer: D

Rationale: A fund is a fiscal and accounting entity with a self-balancing set of accounts.

Topic: Fund Categories

LO: 1

4. The three broad categories of funds used by state and local governmental entities are:
 - a. Governmental, Proprietary, and Fiduciary
 - b. Unrestricted, Partially Restricted, and Fully Restricted
 - c. General, Special, and Fiduciary
 - d. General, Enterprise, and Fiduciary

Answer: A

Rationale: The three categories of funds used by state and local governmental entities are: governmental-type funds, proprietary type funds, and fiduciary type funds.

Topic: Fund Categories

LO: 1

5. Which category of funds is used to account for most of the day-to-day public services provided by a government?
- Fiduciary type funds
 - Enterprise type funds
 - Proprietary type funds
 - Governmental-type funds

Answer: D

Rationale: Governmental-type funds are the predominant category of funds for general-purpose governments and are used to account for most day-to-day public services. The General Fund is a governmental-type fund.

Topic: Measurement Focus and Basis of Accounting

LO: 1

6. Which category of funds focuses on financial resources available for current spending?
- Enterprise type funds
 - Proprietary type funds
 - Governmental-type funds
 - Fiduciary type funds

Answer: C

Rationale: Governmental-type funds use the current financial resources measurement focus.

Topic: Fund Categories

LO: 1

7. The broad categories of funds used in government accounting do **not** include which one of the following?
- Business
 - Governmental
 - Proprietary
 - Fiduciary

Answer: A

Rationale: The three categories of funds used by state and local governmental entities are: governmental-type funds, proprietary type funds, and fiduciary type funds.

Topic: Measurement Focus and Basis of Accounting

LO: 1, 2

8. Which basis of accounting is used by funds that have a current financial resources measurement focus?
- Full accrual basis
 - Cash basis
 - Modified accrual basis
 - Modified cash basis

Answer: C

Rationale: Governmental-type funds use the current financial resources measurement focus and modified accrual basis of accounting.

Topic: Measurement Focus and Basis of Accounting

LO: 2

9. Which of the following funds all use the current financial resources measurement focus?
- Debt Service Fund, Special Revenue Fund, and Capital Projects Fund
 - General Fund, Debt Service Fund, and Internal Service Fund
 - Debt Service Fund, Investment Trust Fund, and Capital Projects Fund
 - General Fund, Debt Service Fund, and Pension Trust Fund

Answer: A

Rationale: Governmental-type funds use the current financial resources measurement focus and modified accrual basis of accounting. Governmental-type funds include the General Fund, Special Revenue Funds, Capital Projects Funds, Debt Service Funds, and Permanent Funds.

Topic: Measurement Focus and Basis of Accounting

LO: 2

10. Within a fund, which of the following results from using the current financial resources measurement focus?
- Capital assets will be depreciated
 - Property taxes will be recognized on the cash basis of accounting
 - A liability must be reported for unsettled claims, provided payment ultimately will be made
 - Unmatured long-term liabilities will not be recorded in the fund

Answer: D

Rationale: When the current financial resources measurement focus is used, only financial assets, short-term liabilities, and matured long-term liabilities are reported.

Topic: Measurement Focus and Basis of Accounting—Revenue Recognition

LO: 2

11. The General Fund levies property taxes in the amount of \$1,000,000 for calendar year 2019. It expects to collect \$950,000 during the year, \$30,000 in the first 60 days of the next year, and \$15,000 during the rest of the next year. It does not expect to collect the remaining \$5,000.

How much property tax revenue should it recognize for the year 2019?

- \$1,000,000
- \$980,000
- \$995,000
- \$990,000

Answer: B

Rationale: In the General Fund, property tax revenue is recognized when it is levied and becomes measurable and available. Available means collectible in the current period or soon enough thereafter so it can be used to pay the bills of the current period. For property taxes, "soon enough thereafter" is interpreted as meaning no more than 60 days after the accounting period ends. Thus, the property tax revenue that is recognized for 2019 is the \$950,000 expected to be collected during the year plus the \$30,000 that is expected to be collected in the first 60 days of the next year.

Topic: Measurement Focus and Basis of Accounting

LO: 2

12. Under modified accrual accounting, when are revenues considered to be "available?"
- When cash has been collected
 - When cash is collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period
 - When cash is on hand or reasonably expected to be collected at any time in the future so they can pay liabilities incurred in the current period
 - When property tax bills have been mailed

Answer: B

Rationale: Available means collectible in the current period or soon enough thereafter so it can be used to pay the bills of the current period.

Topic: General Fund

LO: 2

13. Which of the following is an example of activities that are likely to be accounted for in a government's General Fund?
- Business-type activities of a government that are financed by user charges
 - Sales taxes collected by a state on behalf of counties within the state
 - Property taxes to be used to provide basic government services
 - Donations that must be kept intact, but whose income must be used to beautify parks

Answer: C

Rationale: Property taxes used to provide basic government services are accounted for in the General Fund. Business-type activities of a government are accounted for in a proprietary type fund. Sales taxes collected by a state on behalf of counties within the state are probably accounted for in a Custodial Fund. Donations that must be kept intact, but whose income must be used to beautify parks, would be accounted for in a Permanent Fund.

Topic: Measurement Focus and Basis of Accounting

LO: 2

14. Which of the following terms **best** describes the types of assets accounted for in governmental-type funds?
- Any resource that can be used to provide service to the citizenry
 - Financial assets and capital assets
 - Current assets and movable fixed assets
 - Financial assets

Answer: D

Rationale: Governmental-type funds use the current financial resources measurement focus. When the current financial resources measurement focus is used, only financial assets, short-term liabilities, and matured long-term liabilities are reported.

Topic: General Fund

LO: 2

15. For financial reporting purposes, a government may have only one
- Capital Projects Fund
 - Enterprise Fund
 - General Fund
 - Permanent Fund

Answer: C

Rationale: Governments may have multiple Capital Projects Funds, Enterprise Funds, and Permanent Funds, but can have only one General Fund.

Topic: General Fund

LO: 2

16. Which of the following activities is the most likely to be accounted for in a General Fund?
- Payment of salaries of police and firefighters
 - Construction of a new school building from bond proceeds
 - Accumulation of resources to pay pension benefits to employees
 - Accumulation of resources required by law to be used only to beautify parks

Answer: A

Rationale: The General Fund is used to account for most of a government's day-to-day operations, such as the payment of salaries for police and firefighters. Construction of a major capital project—like a new school—likely will be accounted for in a Capital Projects Fund. Accumulation of resources to pay pension benefits to employees likely will be accounted for in a Pension Trust Fund assuming a qualifying trust arrangement exists. Accumulation of resources required by law to be used only to beautify parks will likely be accounted for in a Special Revenue Fund (if resources are to be used for operations) or possibly a Capital Projects Fund (if resources are to be used for construction of capital assets).

Topic: Measurement Focus and Basis of Accounting

LO: 2

17. Which of the following types of liabilities is least likely to appear in the balance sheet of a governmental-type fund?
- Amounts owed to suppliers of goods and services
 - Amounts owed to bondholders over the entire 20-year life of a debt
 - Amounts owed to other funds
 - Amounts owed to employees for services performed before an accounting period ends

Answer: B

Rationale: Governmental-type funds use the current financial resources measurement focus. When the current financial resources measurement focus is used, only financial assets, short-term liabilities, and matured long-term liabilities are reported. Amounts owed to bondholders over the entire 20-year life of a debt is a long-term liability, which has not matured.

Topic: Measurement Focus and Basis of Accounting—Revenue Recognition

LO: 2

18. At what point are revenues recognized in the General Fund?
- When the revenues are earned
 - When cash is received
 - When the revenues are measurable and available
 - When billings are mailed to service recipients

Answer: C

Rationale: In the General Fund, revenues are recognized on the modified accrual basis of accounting, which requires that recognized revenues be measurable and available.

Topic: Debt Service Fund

LO: 2

19. What is the purpose of a debt service fund?
- To accumulate financial resources for paying interest on all debt issued by the government
 - To account for all outstanding long-term and short-term debt issued by the government
 - To account for outstanding general long-term debt
 - To accumulate financial resources for paying principal and interest on general long-term debt

Answer: D

Rationale: A Debt Service Fund accounts for and reports on financial resources that are restricted or otherwise limited to spending for principal and interest on general long-term debt.

Topic: Capital Projects Funds

LO: 2

20. Which of the following statements about Capital Projects Funds is true?
- The assets of a Capital Projects Fund include both financial and capital assets
 - All capital assets acquired by a government are paid for from a Capital Projects Fund
 - A Capital Projects Fund accounts for resources that are restricted or otherwise limited to spending for capital outlays
 - When capital assets are financed through the issuance of long-term debt, that long-term debt is accounted for in a Capital Projects Fund.

Answer: C

Rationale: By definition, a Capital Projects Fund accounts for resources that are restricted or otherwise limited to spending for capital outlays. Only financial assets, short-term liabilities, and matured long-term liabilities are reported in a Capital Projects Fund. Capital assets and long-term debt are not accounted for in a Capital Projects Fund. Many capital assets, such as copiers and computers, often are purchased using the resources in the General Fund. Long-term debts associated with proprietary type funds are reported in those funds, not in a Capital Projects Fund.

Topic: Special Revenue Funds

LO: 2

21. A state legislature enacts a new park entrance fee that may be used only for maintaining the collection of tropical plants in that state's nationally famous Prospect Park. Which type of fund should be used to account for those resources?
- Special Revenue Fund
 - General Fund
 - Internal Service Fund
 - Custodial Fund

Answer: A

Rationale: Special Revenue Funds are used to account for specific revenue sources that are restricted or committed to spending for specific purposes other than debt service or capital projects.

Topic: Special Revenue Funds

LO: 2

22. A city has an *Arts and Cultural Fund* that is used to account for private contributions that are restricted by the donors for the financing of the city's museum operations and functions. The Arts and Cultural Fund is a:
- General Fund
 - Special Revenue Fund
 - Permanent Fund
 - Private-Purpose Trust Fund

Answer: B

Rationale: Special Revenue Funds are used to account for specific revenue sources that are restricted or committed to spending for specific purposes other than debt service or capital projects.

Topic: Measurement Focus and Basis of Accounting—General Fund

LO: 2

23. Which of the following pairs of accounts are likely to appear on the balance sheet of a government's General Fund?
- Cash and buildings
 - Cash and investments
 - Accounts payable and long-term bonds payable
 - Current portion of bonds payable and non-current portion of bonds payable

Answer: B

Rationale: The General Fund uses the current financial resources measurement focus. When the current financial resources measurement focus is used, only financial assets, short-term liabilities, and matured long-term liabilities are reported.

Topic: Permanent Fund

LO: 2

24. How are the earnings of a Permanent Fund used?
- The earnings remain indefinitely in a permanent fund.
 - The earnings are used only for non-governmental programs.
 - The earnings are used for programs that benefit the government or its citizens.
 - The earnings must be used for permanent projects, such as bridges.

Answer: C

Rationale: Permanent Funds are used to report resources that are legally restricted so that only the earnings generated by the principal may be used to support programs that benefit the government or its citizens.

Topic: Permanent Fund

LO: 2

25. The *Dillard Park Fund* is used to account for a private donation by Mr. and Mrs. Bud Dillard. When making the donation, the Dillard's stipulated that only the income from this fund could be used for the operations of Dillard Park, a city owned park. The Dillard Park Fund is a:
- General Fund
 - Special Revenue Fund
 - Permanent Fund
 - Private-Purpose Trust Fund

Answer: C

Rationale: Permanent Funds are used to report resources that are legally restricted so that only the earnings generated by the principal may be used to support programs that benefit the government or its citizens.

Topic: Governmental Fund Accounting Equation

LO: 2

26. A General Fund has total liabilities in excess of its total assets at the end of the fiscal year. It has no deferred resource inflows or outflows. Which of the following statements is always true?
- Fund balance is negative
 - Cash is less than short-term receivables
 - Payables exceed receivables
 - Payables exceed cash

Answer: A

Rationale: The governmental fund accounting equation is: Financial Assets = Short-term and Matured Long-Term Liabilities + Fund Balance. If liabilities are greater than assets, then fund balance must be negative to make the equation balance.

Topic: Measurement Focus and Basis of Accounting—Special Revenue Funds

LO: 2

27. Which measurement focus and basis of accounting should be used in a Special Revenue Fund?
- | <u>Measurement Focus</u> | <u>Basis of Accounting</u> |
|--------------------------------|----------------------------|
| a. Current financial resources | Full accrual |
| b. Current financial resources | Modified accrual |
| c. Economic resources | Modified accrual |
| d. Economic resources | Full accrual |

Answer: B

Rationale: Governmental-type funds use the current financial resources measurement focus and modified accrual basis of accounting. A Special Revenue Fund is a governmental-type fund.

Topic: Governmental-Type Funds

LO: 1, 2

28. The information generated from the accounting system of a governmental-type fund
- is budget oriented
 - measures profitability
 - measures operational efficiency
 - is intended for use only by legislators

Answer: A

Rationale: The accounting and financial reporting for governmental-type funds is generally consistent with a budgetary notion. This includes the measurement focus and basis of accounting for these funds as well as the governmental-type fund's operating statement. Governmental-type funds do not include a measure of profitability or net income. Further, the accounting system for governmental-type funds generates information about the sources and uses of financial resources but does not provide information about operational efficiency. Users of governmental-type fund information includes the citizenry and investors or creditors in addition to legislators.

Topic: Capital Projects Fund

LO: 2

29. A local government sells bonds having a face value of \$1,000,000 at par. The bond proceeds will be accounted for in a Capital Projects Fund. What account will be credited to offset the debit to cash?
- Other financing sources
 - Citizens' equity
 - Fund balance
 - Bonds payable

Answer: A

Rationale: Long-term liabilities are not reported in Capital Projects Funds. When bonds are issued, the inflow of resources is reported as a credit to an account entitled, "Other financing sources" and as a debit to Cash.

Topic: General Fund

LO: 2

30. A long-term loan from the General Fund to another fund is accounted for in the General Fund as:
- Due from other fund
 - Due to other fund
 - Advance to other fund
 - Advance from other fund

Answer: C

Rationale: A long-term loan from the General Fund to another fund is accounted for as an "Advance to other fund." A short-term loan from the General Fund to another fund is accounted for as a "Due from other fund."

Topic: Measurement Focus and Basis of Accounting

LO: 2

31. Which of the following accounts is associated with the current financial resources measurement focus but not with the economic resources measurement focus?
- a. Assets
 - b. Expenditures
 - c. Revenues
 - d. Liabilities

Answer: B

Rationale: Expenditures are associated with the current financial resources measurement focus. Expenses are associated with the economic resources measurement focus.

Topic: Capital Projects Fund

LO: 2

32. A city uses a *Library Fund* to account for proceeds restricted for an addition to the main library and construction of neighborhood libraries. The Library Fund is a:
- a. Capital Projects Fund
 - b. General Fund
 - c. Permanent Fund
 - d. Debt Service Fund
 - e. Private-Purpose Trust Fund

Answer: A

Rationale: A Capital Projects Fund accounts for resources that are restricted or otherwise limited to spending for capital outlays. The addition to the main library and construction of neighborhood libraries result in capital outlays.

Topic: Measurement Focus and Basis of Accounting—General Fund and Enterprise Fund

LO: 2, 3

33. A governmental entity has a General Fund and an Enterprise Fund. At the beginning of the year, neither fund has any unpaid salary liability. During the year, both funds paid salaries of \$600,000. In addition, salaries for the last three days of the fiscal year (\$15,000 for each fund) will be paid during the first week of the next fiscal year.

How much should each fund report as salary expenditures (expenses) for the fiscal year?

	<u>General Fund</u>	<u>Enterprise Fund</u>
a.	\$600,000	\$615,000
b.	\$600,000	\$600,000
c.	\$615,000	\$600,000
d.	\$615,000	\$615,000

Answer: D

Rationale: In governmental-type funds, operating expenditures for salaries are recognized in the period in which the related liability is incurred because the liabilities are due and payable shortly after they are incurred. Therefore, the General Fund reports an expenditure for salaries of \$615,000 (\$600,000 paid in cash plus \$15,000 that is due and payable at year-end). Enterprise Funds use accrual accounting so it will report a salary expense of \$615,000.

Topic: Measurement Focus and Basis of Accounting—General Fund and Enterprise Fund

LO: 2, 3

34. A city has a General Fund and an Enterprise Fund. During the year, legal claims are filed against the resources of both funds. City attorneys believe that each claim will ultimately be settled for about \$55,000, but settling claims of this kind usually is about a three-year process. How much should be reported as a liability in each fund's balance sheet at the end of the current year?

	<u>General Fund</u>	<u>Enterprise Fund</u>
a.	\$0	\$0
b.	\$0	\$55,000
c.	\$55,000	\$0
d.	\$55,000	\$55,000

Answer: B

Rationale: In governmental-type funds, some liabilities do not have to be liquidated with cash or other resources that are on hand. Liabilities for legal claims and the related expenditures are recognized when they mature. This is a modification to the accrual basis of accounting. Therefore, the General Fund reports no liability for the legal claims that likely will require three years to process. The Enterprise Fund, which uses accrual accounting, will report a \$55,000 liability immediately.

Topic: Proprietary Type Funds

LO: 3

35. Which of the following is a distinguishing characteristic of proprietary funds?
- They recognize revenues when they are measurable and available
 - They always earn sufficient revenues to cover their expenses
 - They charge fees for the services they provide
 - They are legally prohibited from selling services to other governmental agencies

Answer: C

Rationale: Proprietary funds charge a fee for the goods or services that they provide. They recognize revenues on the accrual basis. They may have more expenses than revenues in a year.

Topic: Internal Service Funds

LO: 3

36. A government establishes a central motor pool to provide service to governmental departments and agencies. The pricing objective of the central motor pool is to break-even by charging all agencies a user fee. What type of fund should be established for this activity?
- Special Revenue Fund
 - Custodial Fund
 - Permanent Fund
 - Internal Service Fund

Answer: D

Rationale: Internal Service Funds are used to account for providing goods or services within the reporting government or to other governments, on a user-charge, cost-reimbursement basis.

Topic: Internal Service Funds

LO: 3

37. Which of the following is an appropriate objective of an Internal Service Fund?
- Accounting for the full costs of services, including depreciation of capital assets, to provide a basis for charging governmental users
 - Providing services to other governmental agencies without charge
 - Temporarily holding tax resources on behalf of another government
 - Accounting for the full costs of providing services to the general public

Answer: A

Rationale: Internal Service Funds are used to account for providing goods or services within the reporting government or to other governments, on a user-charge, cost-reimbursement basis. To determine a proper charge for services on a cost-reimbursement basis, the full cost of services, including depreciation, needs to be considered.

Topic: Enterprise Funds

LO: 3

38. A municipal government decides to construct and operate a public swimming pool. It will charge user fees to recover its costs, but will allow senior citizens and children under the age of three to enter at half-price. What type of fund should it use for this purpose?
- Special Revenue Fund
 - Enterprise Fund
 - Custodial Fund
 - Private Purpose Fund

Answer: B

Rationale: Enterprise Funds may be used to account for any activity whose products or services are sold for a fee to external users. Enterprise funds must be used if an activity has a pricing policy (that is, sets fees and charges) designed to recover its costs.

Topic: Reporting on Proprietary Fund Types—Enterprise Funds

LO: 3

39. In what section of the Enterprise Fund statement of revenues, expenses, and changes in fund net position is interest income generally reported?
- With operating revenues
 - With nonoperating revenues
 - Either with extraordinary or special items, depending on the circumstances
 - With capital contributions and transfers

Answer: B

Rationale: Interest income generally is reported as a part of nonoperating revenues because most Enterprise Funds are not primarily in business to loan money.

Topic: Measurement Focus and Basis of Accounting—Internal Service Funds

LO: 3

40. Which measurement focus and basis of accounting should be used in an Internal Service Fund?

<u>Measurement Focus</u>	<u>Basis of Accounting</u>
a. Current financial resources	Full accrual
b. Current financial resources	Modified accrual
c. Economic resources	Modified accrual
d. Economic resources	Full accrual

Answer: D

Rationale: Internal Service Funds are a proprietary type fund. Proprietary type funds use the economic resources measurement focus and the full accrual basis of accounting.

Topic: Enterprise Funds

LO: 3

41. A government will prepare a statement of cash flows for which of the following funds?

- a. General Fund
- b. Enterprise Fund
- c. Debt Service Fund
- d. Custodial Fund

Answer: B

Rationale: Only proprietary type funds are required to present a statement of cash flows. Enterprise Funds and Internal Service Funds are the only proprietary type funds.

Topic: Statement of Cash Flows

LO: 3

42. Which of the following is true regarding a statement of cash flows prepared by a government?

- a. The statement of cash flows will be identical to one prepared by a business
- b. The statement of cash flows will be prepared using the indirect method
- c. The statement of cash flows will have no more than three cash flow classifications
- d. The statement of cash flows will be prepared using the direct method

Answer: D

Rationale: The GASB requires proprietary type funds to use the direct method the operating activities section of the statement of cash flows. Commercial enterprises, which follow the FASB standards, allow an entity to use either the indirect or direct method. In addition, the GASB requires four cash flow classification while the FASB only requires three.

Topic: Enterprise Funds

LO: 3

43. Which of the following financial statements would be prepared for enterprise funds?

- a. A statement of net position
- b. A statement of cash flows
- c. A statement of revenues, expenses, and changes in net position
- d. All of the above would be prepared.
- e. Only a and c would be prepared.

Answer: D

Rationale: GASB requires Enterprise Funds to prepare a statement of net position; a statement of revenues, expenses, and changes in net position; and a statement of cash flows.

Topic: Measurement Focus and Basis of Accounting

LO: 3, 4

44. Which of the following set of funds use the economic resources measurement focus?
- Enterprise Fund, Special Revenue Fund, and General Fund
 - Internal Service Fund, Pension Trust Fund, and Enterprise Fund
 - Debt Service Fund, Internal Service Fund, and Pension Trust Fund
 - Enterprise Fund, Internal Service Fund, and Capital Projects Fund

Answer: B

Rationale: Proprietary type funds (Enterprise Funds and Internal Service Funds) and fiduciary type funds (Pension Trust Funds, Investment Trust Funds, Private-Purpose Trust Funds, and Custodial Funds) use the economic resources measurement focus. Governmental-type funds use the current financial resources measurement focus.

Topic: Measurement Focus and Basis of Accounting

LO: 4

45. Which of the following is the appropriate measurement focus and basis of accounting for a Private-Purpose Trust Fund?
- The current financial resources measurement focus and the accrual basis of accounting
 - The current financial resources measurement focus and the modified accrual basis of accounting
 - The economic resources measurement focus and the accrual basis of accounting
 - The economic resources measurement focus and the modified accrual basis of accounting

Answer: C

Rationale: Fiduciary type funds (Pension Trust Funds, Investment Trust Funds, Private-Purpose Trust Funds, and Custodial Funds) use the economic resources measurement focus and accrual basis of accounting.

Topic: Fiduciary Type Funds

LO: 4

46. Which of the following are fiduciary type funds?
- Pension Trust Fund, Custodial Fund, and Permanent Fund
 - Investment Trust Fund, Special Revenue Fund, and Internal Service Fund
 - Custodial Fund, Internal Service Fund, and Pension Trust Fund
 - Pension Trust Fund, Investment Trust Fund, and Custodial Fund

Answer: D

Rationale: Pension Trust Funds, Investment Trust Funds, Private-Purpose Trust Funds, and Custodial Funds are fiduciary type funds.

Topic: Custodial Funds

LO: 4

47. A county collects property taxes not only for itself, but also on behalf of all cities within the county. What type of fund should the county use to account for the property taxes held for the cities?
- Private Purpose Trust Fund
 - Custodial Fund
 - Special Revenue Fund
 - Investment Trust Fund

Answer: B

Rationale: Of the funds listed, a Custodial Fund is the only possible option. To use a Custodial Fund, the activity must meet the criteria for a fiduciary activity. This is discussed in detail in Chapter 8.

Topic: Custodial Funds

LO: 4

48. Which of the following is a characteristic of a Custodial Fund's financial reporting?
- a. Its statement of fiduciary net position shows assets, liabilities, and net position
 - b. Its statement of fiduciary net position shows no net position
 - c. Its statement of fiduciary net position shows no liabilities
 - d. Its statement of fiduciary net position shows no assets

Answer: A

Rationale: The statement of fiduciary net position for all fiduciary type funds includes assets, liabilities, and net position. A Custodial Fund is one of four fiduciary type funds.

Topic: Fiduciary Type Funds

LO: 4

49. Which of the following are required financial statements for fiduciary type funds?
- a. Statement of fiduciary net position
 - b. Statement of revenues, expenses, and changes in fiduciary net position
 - c. Statement of cash flows
 - d. All of the above
 - e. Both a. and b.

Answer: A

Rationale: Fiduciary type funds are required to prepare a statement of fiduciary net position and a statement of changes in fiduciary net position.

Topic: Private-Purpose Trust Fund

LO: 4

50. A city establishes a fund to accumulate resources that will be used to provide a college education to the children of police or fire personnel who die as a result of job-related activities. The resources are placed in a trust in which the assets are protected from the government's creditors. Which of the following funds should be used to account for this activity?
- a. Permanent Fund
 - b. Custodial fund
 - c. Private-Purpose Trust Fund
 - d. Pension (and other employee benefit) Trust Fund
 - e. General Fund

Answer: C

Rationale: Private-Purpose Trust Funds are used to report all fiduciary activities that are not required to be reported in Pension (and other employee benefit) Trust Funds or Investment Trust Fund if the resources are held in a trust that meets certain criteria including the assets being protected from the government's creditors. It should be noted that the assets in the trust do not benefit the city.

Topic: Fiduciary Type Funds

LO: 4

51. Which of the following is a distinguishing characteristic of the resources accounted for in fiduciary funds?
- a. They must be held intact in perpetuity.
 - b. They are generally held for very short periods of time.
 - c. They are used only to support programs of the governmental entity having custody of the resources.
 - d. They are not used to support programs of the governmental entity having custody of the resources.

Answer: D

Rationale: One of the distinguishing characteristics of the resources accounted for in fiduciary funds is that they are not used to support programs of the governmental entity having custody of the resources.

Exercises

Topic: Fund Identification

LO: 2, 3

1. A small village maintains a General Fund, Special Revenue Fund, Capital Projects Fund, and Internal Service Fund. State the fund (or funds) that would be used to record each of the following events.
 - a. Property taxes were collected to finance the day-to-day activities of the village.
 - b. The village issued debt for the purpose of constructing a new firehouse.
 - c. The village paid an invoice for construction of a new firehouse.
 - d. Mechanics' salaries were paid by the Motor Pool Fund, which was established to provide a centralized location for servicing all village vehicles on a user-charge basis.
 - e. The village paid the salaries of its police officers.
 - f. The village received a check from the state to help finance the new firehouse.
 - g. The village received a grant, which must be used for beautifying and maintaining nature walks within a park.
 - h. The Motor Pool Fund sent an invoice for maintenance of police and fire vehicles.

Answers:

- a. General Fund
- b. Capital Projects Fund
- c. Capital Projects Fund
- d. Internal Service Fund
- e. General Fund
- f. Capital Projects Fund
- g. Special Revenue Fund
- h. Internal Service Fund and General Fund

Topic: Fund Identification**LO: 2, 3**

2. A large city uses certain governmental-type funds (General, Special Revenue, Debt Service, and Capital Projects) and proprietary-type funds (Internal Service and Enterprise). State the fund or funds that would be used to record the following transactions.
- a. The city sent property tax bills to all taxpayers. Most of the taxes were to be used to finance the day-to-day activities of the city. A portion of the tax, however, was levied for the specific purpose of financing operations of the City Library District, created by vote of the public.
 - b. The city needed a new school. It issued \$4 million of long-term debt and put the proceeds into a fund to finance school construction.
 - c. The city paid the salaries of its police and fire officers.
 - d. To help finance construction of the school, the city received \$1 million from the state.
 - e. Central Vehicle Repair Shop is a city-operated facility that does work for all city agencies and bills the agencies at cost for the work. At the end of the month, Central Vehicle Repair Shop sent invoices to the police department for servicing the police vehicles.
 - f. To pay interest and principal on the debt issued to construct the school, the city transferred \$150,000 from the fund that finances day-to-day activities to the fund that accumulates resources to pay off the debt.
 - g. Metro Bus is a city-operated mass transit facility. Metro Bus deposited passenger fares for the day into its bank account. Also, Metro Bus received an invoice from Central Vehicle Repair Shop for bus repair work.
 - h. The city paid \$500,000 to the contractor that was building the new school.
 - i. The city bought a new police sedan. In accordance with city financial policies, the city paid for the sedan out of its day-to-day operating funds.
 - j. The new school was completed. In accordance with city statutes, all remaining construction assets were sent to the fund that pays the debt service on the construction bonds.

Answers:

- a. General Fund, Special Revenue Fund
- b. Capital Projects Fund
- c. General Fund
- d. Capital Projects Fund
- e. Internal Service Fund, General Fund
- f. General Fund, Debt Service Fund
- g. Enterprise Fund, Internal Service Fund
- h. Capital Projects Fund
- i. General Fund
- j. Capital Projects Fund, Debt Service Fund

Topic: Fund Identification**LO: 2, 3, 4**

3. Indicate which fund or funds would be used by a state to record each of the following events. Use the codes shown below:

General Fund	GF	Pension Trust Fund	PTF
Special Revenue Fund	SRF	Investment Trust Fund	ITF
Debt Service Fund	DSF	Private-Purpose Trust Fund	PPTF
Capital Projects Fund	CPF	Custodial Fund	CF
Enterprise Fund	EF	Internal Service Fund	ISF

- a. The state collected personal income taxes to finance its day-to-day activities.
- b. The state collected gasoline taxes, which in accordance with state law were dedicated solely to the maintenance of state roads.
- c. The state collected a state-enacted sales tax at the rate of 4% of sales. Collections also included a 3% sales tax that certain counties piggy-backed on the state tax. All county sales taxes were deposited in a fund, pending county-by-county analysis of all sales tax returns to determine amounts due to the state and to each county.
- d. As authorized by Public referendum, the state sold \$55 million of bonds to finance a new highway construction program. The debt proceeds were deposited in a fund.
- e. The state received \$15 million from the federal government for the federal share of the costs of constructing the highways (see d. above).
- f. The state office of general services performs centralized printing services for all state agencies, and bills the state agencies at cost for each printing project. The office sent a bill to the State Comptroller for printing the state's annual financial report.
- g. The Office of the State Lottery sells lottery tickets to the public. In accordance with state law, 50% of all lottery ticket sales must be used to finance major capital projects including the acquisition of land for parks. The state received a check from the Office of the State lottery for the state share of the lottery ticket sales.
- h. The state paid the regular bi-weekly payroll of the state police. The state also paid the payroll of personnel who maintain the state roads referred to in transaction b., above.
- i. The state deposited funds received from three county governments into a trust fund. The state will invest the funds and send quarterly checks to the county governments based on the interest earned by the fund.
- j. The Employees Retirement System, a state-operated agency that administers the payment of pensions to retired state employees, paid the monthly pensions.
- k. The state purchased 5 police cars for the State Police at a cost of \$80,000, using day-to-day operating funds. The police cars have a four-year life.
- l. A partial payment was made to the contractors involved in constructing state highways.
- m. The state made an operating transfer, using day-to-day operating funds, to the fund that accumulates resources for payment of debt service on capital projects.
- n. The state paid interest and principal on the debt that had been issued earlier to finance the construction of highways.
- o. The state received collections from individual citizens to pay college education expenses for state National Guard members, who are wounded in military service.

Answers:

- a. GF
- b. SRF
- c. CF, GF
- d. CPF
- e. CPF
- f. ISF, GF
- g. EF, CPF
- h. GF, SRF
- i. ITF
- j. PTF
- k. GF
- l. CPF
- m. GF, DSF
- n. DSF
- o. PPTF

Problem

Topic: Expenditures vs. Expenses

LO: 2, 3

1. A department of a local government began operations at the beginning of the current fiscal year with \$250,000 cash. During the fiscal year, the department made cash disbursements for the following:
 - Salaries and other personnel costs, \$100,000
 - Office rent and utilities, \$24,000
 - Retirement of debt principal, \$10,000; payment of interest, \$2,200
 - Purchased equipment at the beginning of the fiscal year for \$30,000; the equipment is expected to last 6 years and have a salvage value of \$6,000
 - Photocopier rental, \$10,500

Based on the preceding transactions, compute total annual *expenditures* for this department assuming it performs governmental-type activities and is accounted for in the General Fund.

Then compute total annual *expenses* for this department assuming it performs activities within an Enterprise Fund.

Answer:

	General Fund Expenditures	Enterprise Fund Expenses
Salaries and personnel costs	\$100,000	\$100,000
Office rent and utilities	24,000	24,000
Debt service		
Principal	10,000	--
Interest	2,200	2,200
Capital outlay	30,000	--
Depreciation expense $[(\$30,000 - \$6,000) / 6]$	--	4,000
Photocopier rental	10,500	10,500
Totals	<u>\$176,700</u>	<u>\$140,700</u>