

**Manual of Accounting and Financial Reporting for
Pennsylvania Public Schools**

CHAPTER 2
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Chapter 2

Fund Accounting

**** Updated 1/3/05 ****

This Chapter explains the concept of ***fund accounting***, introduced in Chapter 1, which is unique to governmental accounting. All of a government's funds can be classified into one of eleven (11) "fund types." These fund types can be divided into three (3) main categories reflecting:

- ❖ Governmental Activities,
- ❖ Proprietary Activities, And
- ❖ Fiduciary Activities.

❖ The Government Environment

As a local subdivision of the Commonwealth of Pennsylvania, LEAs, as well as other types of local governments, operate under a unique financial environment. These governments are financed in a variety of ways different from the private-sector; thus, requiring a different focus in accounting and financial reporting in the public-sector.

Most government services are financed through taxes and intergovernmental revenues. Taxation is used to finance government services when there has been a public policy decision that individual citizens should not be asked to pay for a given service based upon their use of that service. Intergovernmental revenues are often utilized by a larger government to finance local government services taking advantage of their broader tax base to raise revenues. These revenues are considered “nonexchange revenues” because there is no direct relationship between what an individual is asked to pay and the cost of the services received by that individual. When a service is largely funded through nonexchange revenues, it can be called a “governmental-type activity.”

When a service provided by a government receives a significant portion of its funding through user charges, it can be referred to as a “business-type activity.” These activities are similar to those found in the private sector. Traditionally, the type of financial information desired for governmental-type activities has not been the same as for business-type activities. Accordingly, governments report their governmental-type and business-type activities in separate funds. Also, the focus of financial reporting for business-type activities is quite different from the focus of financial reporting for governmental-type activities. This will be discussed in more detail in a later section of this Chapter.

Governments often hold or manage financial resources in an agent or fiduciary capacity. In this situation, the government operates in a trustee capacity or as an agent.

Another unique aspect to governmental finance is the need to ensure compliance to the numerous restrictions placed on specific resources utilized by governments. For example, management must only spend money with the approval of the Board of Directors. Federal grants are restricted to specific uses. Also, bond proceeds must only be expended for specific projects identified in the actual indenture. Governmental accounting and financial reporting have been adapted to demonstrate compliance with these legal requirements.

Each of the diverse situations described above and the necessity of legal compliance prevent a government from summarizing and reporting all financial transactions and balances in one category, as done with private business. Instead, a government is required to use “fund accounting” to report financial activity. Thus, from an accounting and financial management viewpoint, a governmental unit is a combination of separate accounting entities known as “funds.”

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❖ Fund Accounting

Fund Accounting was developed as a governmental accounting standard in response to a demand for greater financial accountability on the part of state and local governments. As a result, a state or local government is not considered to be a single entity for accounting and financial reporting purposes, but rather a collection of separate funds. Governmental accounting standards state that governments should use the least number of funds to meet legal requirements.

◆ WHAT IS A FUND?

A fund is an accounting entity with a self-balancing set of accounts. Each fund has a separate trial balance, balance sheet, revenues and expenditures/expenses.

◆ WHAT IS THE PURPOSE OF A FUND?

A fund's purpose is to carry on a specific activity or certain objective.

◆ WHEN SHOULD FUNDS BE ESTABLISHED?

A fund should be established to adhere to legal requirements, a specific project or goal, and to achieve good management.

◆ DO SEPARATE FUNDS REQUIRE PHYSICAL SEPARATION OF ASSETS?

Fund Accounting does not require physical separation of cash and investments. The school's total cash and investment balance may be invested or deposited as one.

◆ HOW MANY FUNDS SHOULD SCHOOLS ESTABLISH?

GASB Codification Section 1100.104 states that "governmental units should establish and maintain those funds required by law" and that "only the minimum number of funds consistent with legal and operating requirements should be established ... to avoid inflexibility, undue complexity and inefficiency in financial management."

✓ **PLEASE NOTE:**
You may establish more than one fund within a specific fund type (for example, more than one special revenue fund or several capital project funds to account for specific projects). If more than one fund is established, all funds within a specific fund type must be summarized at the end of the fiscal year for reporting purposes. **Important: *GASB Codification Section 1300.106 requires that "governments report only one general fund."***

For practical purposes, the LEA may find it convenient to maintain separate and distinct components of the General Fund. The LEA may choose to maintain federal program expenditures separate from the general operations of the LEA. Although separate components may be maintained, each component is subject to board control and the laws and regulations governing General Fund operations. All

components of the General Fund must be included as part of the general fund for reporting purposes at the end of the fiscal year.

❖ Categories And Types Of Funds

Three categories of funds are used in governmental accounting. There are a number of “fund types” within each of the three categories. Below is a summary of the three categories and the different fund types used by LEAs. Each fund is also discussed in greater detail later in this chapter.

✓ **PLEASE NOTE:**

LEAs wishing to categorize activity not specifically mentioned in this section should contact the LECS Comptroller’s Office. LECS will help you to categorize the activity so that it is in compliance with State and school laws and subsidy calculation requirements. LEAs may not establish funds other than those presented in this accounting manual without specific written approval from the LECS Comptroller’s Office.

GOVERNMENTAL FUNDS

Governmental funds are the funds through which most LEA functions are typically financed. The focus is on determination of financial position and change in financial position, not on income determination. Four fund types are used to account for a government’s governmental-type activities. They are the **general fund, special revenue fund, capital projects fund, debt service fund and the permanent fund.**

1. General Fund

- Chief operating fund of the LEA. Used to account for all resources not reported in another fund. All LEAs must have a General fund.
- Report only one General Fund.
- Appropriated budgets are adopted. Comparisons of the budgeted to actual results are required on the LEA’s financial statements.

2. Special Revenue Fund

Accounts for the proceeds of specific revenue sources (other than trust funds or major capital projects) that are legally restricted to expenditures for specified purposes. Special Funds differ for Intermediate Units and all other LEAs. Do not confuse Capital Reserve funds with Capital Projects..

Special Revenue Funds To Be Used By Intermediate Units ONLY.

- a) Special Education Transportation Funds
- b) Early Intervention – Handicapped Children Programs
- c) Special Education
- d) Institutionalized Children

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Special Revenue Funds To Be Used By ALL OTHER LEAs.

- a) Capital Reserve Funds established under Sections 690 and 1850 of the School Code.
- b) Capital Reserve Funds established under Section 1432 of the Municipal Code.
- c) Athletic Funds established under Section 511 of the School Code.
- d) Public Purpose Trust fund.
- e) Other Comptroller Office approved funds.



PLEASE NOTE:

Only the above activities should be classified as Special Revenue Funds. Schools must receive written approval from the LECS Comptroller's Office to classify additional activities as Special Revenue.

3. Capital Projects Fund

- Reports major capital acquisition and construction activities (other than those financed by proprietary funds and trust funds).
- One Capital Projects Fund is reported by the LEA.

IMPORTANT: A capital projects fund is not a capital reserve fund.

4. Debt Service Funds

- Accumulates resources for payments of general long-term debt principal and interest.
- The Local Government Unit Debt Act, Section 1001 requires the creation of a Debt Service Fund for debt payments of bonds and notes (other than TANS and small borrowing for capital purposes – Section 409 of LGUDA).
- One Debt Service (Sinking) Fund is reported by the LEA.

IMPORTANT: Make sure debt payments are recorded consistently on the AFR. If you use a debt service fund, do not report debt payments within the expenditure detail of the general fund on the AFR.

5. Permanent Funds

Permanent funds should be used to report resources that are legally restricted to the extent that only earnings, and not principal, may be used for purposes that support the LEA's programs.

PROPRIETARY FUNDS

The funds used to account for LEA activities that are similar to business operations in the private sector; or where the reporting focus is on determining net income, financial position, changes in financial position, and a significant portion of funding through user charges. There are two types of proprietary funds – enterprise funds and internal service funds.

1. Enterprise Fund

- Accounts for operations that are financial and operated in a manner similar to private business, where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods and services to the general public on a continuing basis be financed or recovered primarily or partially through user charges.

- or -

- Accounts for operations where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.
- Examples include a cafeteria fund and a school store.

2. Internal Service Fund

- Accounts for the operation of LEA functions that provide goods or services to other LEA funds, other LEAs or to other governmental units, on a cost-reimbursable basis. Some examples of internal service funds could include those used for central warehousing and purchasing, central data processing, and central printing and duplicating.

FIDUCIARY FUNDS

Fiduciary funds should be used to report assets held in a trustee or agency capacity only for others; and therefore, cannot be used to support the government's own programs. The fiduciary fund category includes pension (and other employee benefit) trust funds, investment trust funds, private-purpose trust funds and agency funds. The three types of trust funds should be used to report resources held and administered by the LEA when it is acting in a fiduciary capacity for individuals, private organizations or other governments. These funds are distinguished from agency funds by the existence of a trust agreement.

1. Pension (and other employee benefit) trust funds

- Should be used to report resources that are required to be held in trust for the members and beneficiaries of defined benefit pension plans,

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defined contribution plans, other postemployment benefit plans or other employee benefit plans.

2. Investment trust funds

- Should be used to report the external portion of investment pools reported by the LEA, as required by GASB Statement #31, Paragraph 18.

3. Private purpose trust funds

- Should be used to report all other trust arrangements under which principal and income benefit individuals, private organizations or other governments (i.e., not the LEA).

4. Agency Fund

- Used in situations where the government collects or temporarily holds resources on behalf of a third party.
- Since all of the assets of an agency fund are associated with outside parties, these funds report assets and liabilities, but no equity.
- If payroll is accounted for in an agency fund, only balance remaining at year end should be reported with the fund where the respective salaries were recorded during the year.
- Student Activity funds are accounted for as Agency funds.

NOTE: The use of trust funds is only appropriate when resources are legally restricted. The Government Finance Officers Association (GFOA) recommends that trust funds only be used in cases where there is a written trust agreement with a party outside of the government.