Internal Service Funds

Chapter 11
Learning Objectives

- Understand nature and usage of ISFs.
- Understand applicable accounting principles.
- Understand pricing policies and methods.
- Prepare basic journal entries.
- Prepare financial statements.
- Understand unique aspects of self-insurance funds.
- Understand problems associated with significant accumulated increases or decreases in total net assets.
Purpose

To finance, administer, and account for departments or agencies whose exclusive or nearly exclusive mission is to provide goods and services to the government’s other departments on a *cost reimbursement* basis.
Goals of ISFs

- Attain greater economy, efficiency, and effectiveness in acquisition and distribution of common goods and services used by other departments
- Facilitate the equitable sharing of costs among departments served
General Principles

- Measurement Focus – economic resources
- Basis of Accounting – accrual
Pricing Policies

- Typical choices
  - Historical cost
  - Direct cost, when other costs are insignificant

- ISFs usually have a monopoly, so pricing needs to be monitored closely

- Excessive charges *must* be avoided
Pricing Methods

1. Predetermined rates – so much per page, mile, or order
2. Charge departments based on actual cost

Predetermined rates preferred because

- Departments need to know charges at time work is done
- Actual cost charges may result in inequitable allocations among departments
Relation to Budget

Budget may not be used since level of activity depends on demand, not predetermined spending by the fund.
Financial Statements

- Statement of Net Assets
- Statement of Revenues, Expenses, and Changes in Net Assets
- Statement of Cash Flows
Self-Insurance Fund (SIF)

- Full insurance coverage for all types of risk can be prohibitive expensive
- Self-insurance used to cover some losses
- Amounts set aside should be actuarially determined
Consolidating Risk Financing Activities

GASB Statement #10 gives governments two options:

- General Fund
- Internal Service Fund
General Fund

- All claims and judgments recorded in GF when paid or due
- Remainder is recorded in GLTL accounts
- Amounts charged to other funds recorded as reduction of expenditures – reimbursements, not revenues
- May not accumulate reserves for catastrophic losses
Internal Service Fund

- All claims and judgments recorded in ISF when incurred – may be current or long-term liability
- GLTL accounts are *not* involved
- Amounts charged to other funds recorded as revenues
- May accumulate reserves for catastrophic losses
Requirements in Using ISFs

- Recognize all claims & judgments liabilities & expenses in ISF
- Charge other funds amounts that are reasonable and equitable – preferably actuarially based – so that ISF revenues and expenses are approximately equal
- Accumulated net assets should be disclosed in notes as being designated for future catastrophic losses
- Determine whether amounts paid to ISFs that differ from required amounts are in substance interfund loans or transfers
Accounting Aspects for SIFs

- Revenues from billings to departments
- Investment of SIF resources
- Recognition and settlement of claims & judgments
Revenue Recognition

- Amounts paid based on actuarial estimates should be recorded as revenues.

- Overpayments
  - If intended to cover next year’s contribution, record as deferred revenues.
  - If not so intended, payment may be a loan, advance, or transfer.
Expense Recognition

- Information prior to issuance of financial statements indicate that it is **probable** that an asset was impaired or a liability was incurred at date of statements. **AND**

- Amount of loss can be **reasonably** estimated.
Disposition of Increase/Decrease in Net Assets

- Charged or credited to billed departments based on usage.
- Closed to Net Assets with intention of modifying subsequent years’ charges.
- Closed to Net Assets with no adjustments – assumes that fund will have profitable and loss years and will breakeven over time.
Reasons for Building Net Asset Balances

- Accumulate resources for catastrophic losses
- Planned purchase of additional capital assets or expanded operations