



GROSSMAN YANAK & FORD LLP
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EXPENSE ALLOCATIONS & BUDGETING BEST PRACTICES

Not-for-Profit Webinar

May 8, 2024



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INTRODUCTION

GYF Strongly Believes in Serving Those Who Serve Others

- We are proud that, since our founding in 1990, serving the non-profit industry has been a primary focus for our firm
- Our professionals value a philanthropic spirit and culture and dedicate significant portions of their careers to serving non-profit organizations
- We utilize the expertise gained from assisting other non-profits to help you concentrate on your central purpose and fulfill your mission

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MEET THE EXPERTS



Megan Troxell, CPA
Partner – A&A Services Group
TROXELL@GYF.COM



Robin Ryan, CPA
Director – A&A Services Group
RYAN@GYF.COM

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TODAY'S OBJECTIVES

- Explain the importance of cost allocation
- Investigate different methodologies for expense allocations and consider how to choose the most accurate methodology
- Discuss required financial statement presentation and disclosure, as well as other external reporting
- Review budgeting best practices, with a focus on expenses

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SCOPE

We'll cover today:

- Common expenses
- Functional and natural classification
- Functional allocation
 - FASB reference – unique to NFP
 - Program
 - Supporting services – G&A and fundraising
 - 990 reporting

Excluded from discussion:

- Investment activity, including fees
- Gains and losses, for example from property sales/disposals
- Unusual and infrequent expenses

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EXPENSE ALLOCATIONS

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WHY IS EXPENSE ALLOCATION IMPORTANT?

Importance of expense allocation:

- Understanding expenses and how resources are deployed
- Drivers of expenses
- Assessment of true cost
- Determination of reimbursement cost
- Determination of program fee

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WHY IS EXPENSE ALLOCATION IMPORTANT?

What if we get it wrong?

- Confusion when making decisions
- Spend more than you have
- Miscommunicate your message

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NATURAL VS. FUNCTIONAL CLASSIFICATION

Functional classification

- Describe the purpose of an expense by its category
- *Program services* are activities that result in goods and services being distributed to beneficiaries, customers, or members to fulfill the organizations' purpose or mission
- *Supporting services* are the nonprofit organization's activities other than program services – these generally include management and general, fundraising and membership development activities

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NATURAL VS. FUNCTIONAL CLASSIFICATION

Natural classification

- The kinds of economic benefits received by incurring those expenses or, what the expense was spent on
- Ex. Payroll, insurance, utilities, supplies, depreciation

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STATEMENT OF FUNCTIONAL EXPENSES

The statement of functional expenses is a matrix of BOTH functional and natural classifications of expenses

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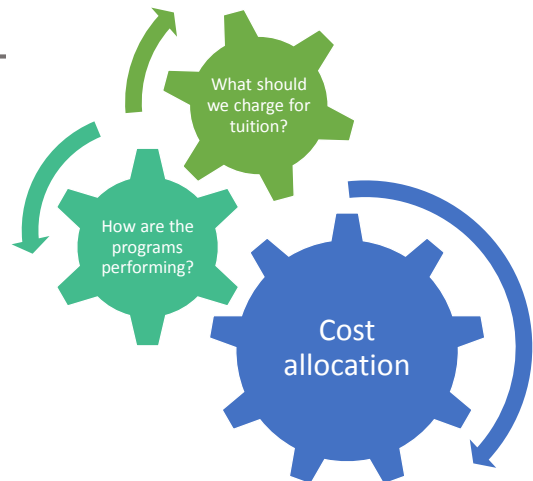


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ILLUSTRATIVE EXAMPLE

Steel City Academy

- NFP with an education focus
- Two programs:
 - School day for which tuition is received
 - Extracurricular which is not fully funded, and, thus contributions are solicited



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ILLUSTRATIVE EXAMPLE

Steel City Academy – Summary

Tuition & scholarships	2,000,000
Participant fees	50,000
Contributions	999,000
Total revenue & support	3,049,000
Salaries & wages	1,845,000
Employee benefits	369,000
Educational resources	200,000
Supplies	100,000
Training	50,000
Facilities	300,000
Depreciation	100,000
Legal & accounting	25,000
Donor relations	60,000
Total expenses	3,049,000
Surplus (Deficit)	-

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ALLOCATION METHODS

Methods for allocating expenses:

- Direct
- Payroll and related costs
 - Time worked
 - Estimates of responsibilities
- Other costs:
 - Time method
 - % of payroll amounts
 - Square footage
 - Headcount (participant, or employee)

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ALLOCATION METHODS: DIRECT

Direct costs:

- 100% assigned to a functional category (or specific program)
- Easily assigned
- No allocation necessary
- Examples: Program-related personnel, program supplies, events (fundraising or program), training, recruitment

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ALLOCATION METHODS: PAYROLL, ET AL.

Payroll and related costs:

- Generally the most significant expenses for NFPs
- Time worked
- Estimates of responsibilities

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PAYROLL ALLOCATION EXAMPLE

	<u>Salary</u>	<u>Extended Cost</u>
Executive Director	\$ 150,000	1 \$ 150,000
Director of Finance	120,000	1 \$ 120,000
Director of Development	100,000	1 \$ 100,000
Director of Operations & Facilities	100,000	1 \$ 100,000
Facilities Manager	75,000	1 \$ 75,000
Principal	100,000	1 \$ 100,000
Teachers	75,000	16 \$ 1,200,000
		<u><u>\$ 1,845,000</u></u>

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PAYROLL ALLOCATION EXAMPLE

	<u>School Day</u>		<u>Extracurricular</u>		<u>G&A</u>		<u>Fundraising</u>		<u>Total</u>
Executive Director	\$ 15,000	10%	\$ 15,000	10%	\$ 60,000	40%	\$ 60,000	40%	\$ 150,000
Director of Finance	6,000	5%	6,000	5%	96,000	80%	12,000	10%	120,000
Director of Development	-		-		-		100,000	100%	100,000
Director of Operations & Facilities	64,000	64%	16,000	16%	20,000	20%	-		100,000
Facilities Manager	48,000	64%	12,000	16%	15,000	20%	-		75,000
Principal	75,000	75%	25,000	25%	-		-		100,000
Teachers	960,000	80%	240,000	20%	-		-		1,200,000
Total payroll expenses	\$1,168,000		\$ 314,000		\$191,000		\$ 172,000		\$1,845,000

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ALLOCATION METHODS: OTHER COSTS

Methods for allocating other costs:

- Time method – using the same estimates determined for payroll allocation
- % of payroll amounts – will differ slightly from the time method

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TIME VS. % OF PAYROLL METHODS

	School Day	Extracurricular	G&A	Fundraising	Total
% of Payroll Costs Method	\$ 63,000 63%	\$ 17,000 17%	\$ 10,000 10%	\$ 9,000 9%	\$ 100,000
Time Method	\$ 68,091 68%	\$ 17,818 18%	\$ 7,273 7%	\$ 6,818 7%	\$ 100,000

	School Day	Extracurricular	G&A	Fundraising	Total
Executive Director	\$ 15,000 10%	\$ 15,000 10%	\$ 60,000 40%	\$ 60,000 40%	\$ 150,000
Director of Finance	6,000 5%	6,000 5%	96,000 80%	12,000 10%	120,000
Director of Development	-	-	-	100,000 100%	100,000
Director of Operations & Facilities	64,000 64%	16,000 16%	20,000 20%	-	100,000
Facilities Manager	48,000 64%	12,000 16%	15,000 20%	-	75,000
Principal	75,000 75%	25,000 25%	-	-	100,000
Teachers	960,000 80%	240,000 20%	-	-	1,200,000
Total payroll expenses	\$ 1,168,000 63%	\$ 314,000 17%	\$ 191,000 10%	\$ 172,000 9%	\$ 1,845,000

	School Day	Extracurricular	G&A	Fundraising	Total
Executive Director	4 10%	4 10%	16 40%	16 40%	40
Director of Finance	2 5%	2 5%	32 80%	4 10%	40
Director of Development	-	-	#	40 100%	40
Director of Operations & Facilities	26 64%	6 16%	8 20%	-	40
Facilities Manager	26 64%	6 16%	8 20%	-	40
Principal	30 75%	10 25%	#	-	40
Teachers	512 80%	128 20%	#	-	640
Total payroll expenses	599 68%	157 18%	64 7%	60 7%	880

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ALLOCATION METHODS: OTHER COSTS

Methods for allocating other costs:

- Square footage
 - Allocates costs proportionate to an activity’s share of the facility space
 - Typically applied to occupancy-related costs

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ALLOCATION METHODS: SQUARE FOOTAGE

	<u>School Day</u>		<u>Extracurricular</u>		<u>G&A</u>		<u>Fundraising</u>		<u>Total</u>
Square footage used	50,400	52.5%	16,800	17.5%	19,200	20.0%	9,600	10.0%	96,000
Facilities	157,500	52.5%	52,500	17.5%	60,000	20.0%	30,000	10.0%	300,000
Depreciation	52,500	52.5%	17,500	17.5%	20,000	20.0%	10,000	10.0%	100,000
Total occupancy-related expenses	210,000	52.5%	70,000	17.5%	80,000	20.0%	40,000	10.0%	400,000

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ALLOCATION METHODS: OTHER COSTS

Methods for allocating other costs:

- Headcount
 - Allocates costs proportionate to the number of people (ex. participants, employees)
 - Applied to resource-related costs

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ALLOCATION METHODS: HEADCOUNT

	<u>School Day</u>		<u>Extracurricular</u>		<u>Total</u>
Participants	320	40.0%	480	60.0%	800
Educational resources	80,000	40.0%	120,000	60.0%	200,000

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ILLUSTRATIVE EXAMPLE: METHODS USED

	Method	School Day	Extracurricular	G&A	Fundraising	Total
Salaries & wages	Estimate of time	63%	17%	10%	9%	100%
Employee benefits	Estimate of time	63%	17%	10%	9%	100%
Educational resources	Headcount	40%	60%	0%	0%	100%
Supplies	Time	68%	18%	7%	7%	100%
Training	Direct		-- N/A --			
Facilities	Square Footage	53%	18%	20%	10%	100%
Depreciation	Square Footage	0%	0%	0%	0%	0%
Legal & accounting	Direct		-- N/A --			
Donor relations	Direct		-- N/A --			

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ILLUSTRATIVE EXAMPLE: FINAL

	School Day	Extracurricular	G&A	Fundraising	Total
Tuition & scholarships	2,000,000				2,000,000
Participant fees		50,000			50,000
Contributions				999,000	999,000
Total revenue & support	2,000,000	50,000	-	999,000	3,049,000
Salaries & wages	1,168,000	314,000	191,000	172,000	1,845,000
Employee benefits	233,600	62,800	38,200	34,400	369,000
Educational resources	80,000	120,000	-	-	200,000
Supplies	68,091	17,818	7,273	6,818	100,000
Training	35,000	5,000	5,000	5,000	50,000
Facilities	157,500	52,500	60,000	30,000	300,000
Depreciation	52,500	17,500	20,000	10,000	100,000
Legal & accounting	-	-	25,000	-	25,000
Donor relations	-	-	-	60,000	60,000
Total expenses	1,794,691	589,618	346,473	318,218	3,049,000
Surplus (Deficit)	205,309	(539,618)	(346,473)	680,782	-

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EXPENSE ALLOCATION: PRESENTATION & DISCLOSURE

Properly allocated expenses will be reported:

- In the organization's financial statements
- On the Form 990
- For internal use – dashboards & benchmarks

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EXPENSE ALLOCATION: PRESENTATION & DISCLOSURE

Organizations can choose to present an analysis of expenses by their functional and natural classifications:

- On the face of the statement of activities
- In a separate financial statement
- As a schedule in the notes
- FASB ASC 958-720-45

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EXPENSE ALLOCATION: PRESENTATION & DISCLOSURE

Programs should be separately reported if it meets at least one of the following criteria:

- Its revenues or expenses are 10% or more of the organization's total revenues or expenses
- Its identifiable assets or liabilities are 10% or more of the organization's combined identifiable assets or liabilities

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COMPLEXITIES IN EXPENSE ALLOCATION

What complexities might you encounter?

- Grant/funder limitations or restrictions
- Striking a balance between reasonably accurate and overly detailed
- Performing calculations:
 - Manually in spreadsheets
 - Automated in your accounting system

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CHANGES IN EXPENSE ALLOCATION

When should you change your expense allocation?

- Management should periodically evaluate its allocation methods and revise them when necessary to reflect significant changes in the nature or level of the organization’s current activities
- Once an allocation method has been established, changing it may represent a change in accounting principles, unless events related to the basis for the allocation are clearly different in substance than those that previously occurred

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STATEMENT OF FUNCTIONAL EXPENSES

Form 990 Excerpt

Form 990 (2023) Page 10

Part IX Statement of Functional Expenses

Section 501(c)(3) and 501(c)(4) organizations must complete all columns. All other organizations must complete column (A).

Check if Schedule O contains a response or note to any line in this Part IX

Do not include amounts reported on lines 6b, 7b, 8b, 9b, and 10b of Part VIII.

	(A) Total expenses	(B) Program service expenses	(C) Management and general expenses	(D) Fundraising expenses
1 Grants and other assistance to domestic organizations and domestic governments. See Part IV, line 21				
2 Grants and other assistance to domestic individuals. See Part IV, line 22				
3 Grants and other assistance to foreign organizations, foreign governments, and foreign individuals. See Part IV, lines 15 and 16				
4 Benefits paid to or for members				
5 Compensation of current officers, directors, trustees, and key employees				
6 Compensation not included above to disqualified persons (as defined under section 4958(f)(1)) and persons described in section 4958(c)(3)(B)				
7 Other salaries and wages				
8 Pension plan accruals and contributions (include section 401(k) and 403(b) employer contributions)				
9 Other employee benefits				
10 Payroll taxes				

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EXPENSE ALLOCATIONS

Dashboards & Benchmarks

- Identify key performance indicators for your organization; examples:
 - Cost per participant – is there a threshold you don't want to exceed?
 - Surplus/deficit – overall and by program
 - Program to supporting services ratio

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BUDGETING BEST PRACTICES

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ROLE OF BUDGETING

What role does budgeting play in an organization?

- Effective financial management is an ongoing process that features a cycle of good management habits – an integral part of this is thoughtful budgeting and monitoring
- How can your organization execute its mission without a plan?
- Budgeting is a form of risk management and transparency

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BUDGETING – WHAT INFORMATION IS NEEDED?

History tells the story of where you've been

- Current year-to-date comparison to budget
- Forecast out to the end of the year

What is the plan for the future?

- Trends and expectations
- Not all budget figures are dollars and cents

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BUDGETING FOR EXPENSES

How will strategic plans and growth (or decline) of the Organization impact budgeting for expenses?

What are the key drivers for your expenses?

- Personnel-related likely the largest category
- Fulfilling the organization's mission

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BUDGETING FOR EXPENSES

Key drivers for expenses

- Personnel-related – how many employees do you need to support the people you are serving?
- Residential – Occupancy (“Heads in Beds”)
- Per diem rates for services provided – what is the cost?
- Educational – tuition rates or program registration fees – managing the related costs
- Special events

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BUDGETING FOR EXPENSES

Additional considerations:

- Volatility
- Identify variables and future growth (or contraction)
- Multiple scenarios
- Consider restrictions and long-term plans

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WE HAVE OUR BUDGET... NOW WHAT?

- Monitor, analyze, refine, repeat...
- Informed employees result in accountability**
- Avoid conflicting messages to different stakeholders*
- Be prepared for the unexpected
- Ask questions, challenge the budget and welcome this from others
- Align budget with your internal reporting or general ledger format

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REVIEW AND ANALYSIS

- Should be done regularly (possibly in preparation for Board meetings)
- Prepare budget vs. actual reports for staff and Board (consider timing differences)
- Forecast through the end of the year
- Create an action plan to address budget shortfalls
- Revise the budget if necessary

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RESOURCES FOR NONPROFITS

- www.nonprofitaccountingbasics.org
- www.councilofnonprofits.org
- www.nonprohithub.org

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QUESTIONS?

Thank You for Attending the Program!

Visit our website for more NFP resources:

WWW.GYF.COM

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PLEASE REACH OUT IF YOU NEED ASSISTANCE

 A circular portrait of Megan Troxell, a woman with blonde hair, smiling.

Megan Troxell, CPA
Partner – A&A Services Group
 TROXELL@GYF.COM

 A circular portrait of Robin Ryan, a woman with brown hair, smiling.

Robin Ryan, CPA
Director – A&A Services Group
 RYAN@GYF.COM

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