

Expenses: Functional Reporting & Cost Allocation



Elizabeth Pilacik, CPA
Director
Audit & Accounting

www.kmco.com

Kreischer
Miller

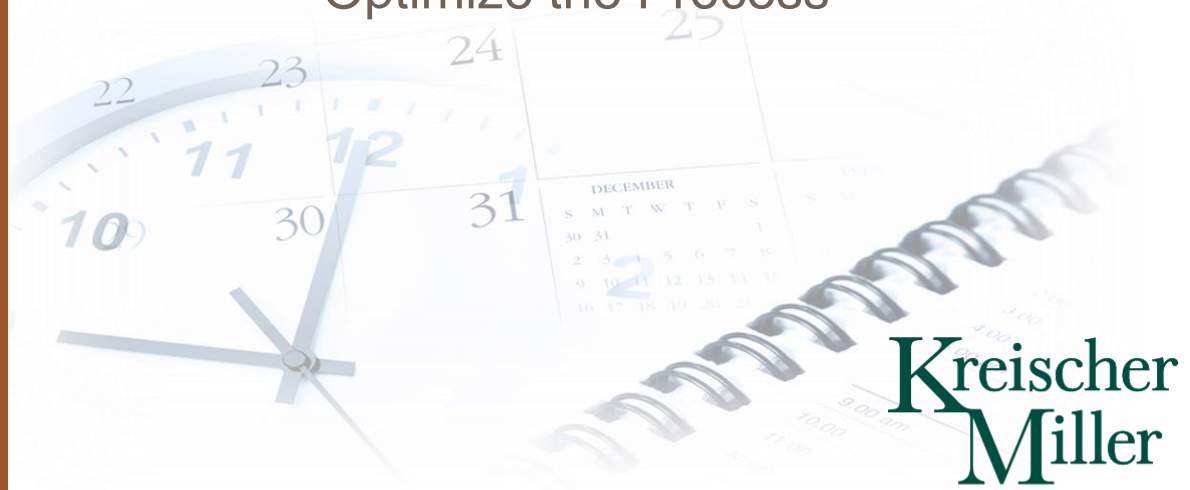
PEOPLE | IDEAS | SOLUTIONS

Learning Objectives

- Address the basic requirements for reporting and allocating expenses by function
- Discuss the various methods used to optimize your organization's cost allocation process

Agenda

- Expenses – Functional Classification & Reporting
 - Purpose & Significance
 - What's Required
- Cost Allocation
 - Objectives
 - Cost Drivers & Methodologies
 - Optimize the Process



**Kreischer
Miller**

Expenses

Functional Classification & Reporting



PEOPLE | IDEAS | SOLUTIONS

Expenses – Functional Classification & Reporting

- Purpose
 - To report meaningful information about how the organization uses its resources to accomplish its mission
- Significance
 - Informed decision-making
 - External
 - Internal
 - Measure of stewardship



PEOPLE | IDEAS | SOLUTIONS

Expenses – Functional Classification & Reporting

- What's Required
 - Accounting Standards – GAAP
 - Report expenses by **functional classification** – a method of grouping expenses according to the purpose for which costs are incurred
 - Disaggregate the functional expense classifications by the natural expense classifications
 - Report information about all expenses in one location
 - Disclose allocation methods



PEOPLE | IDEAS | SOLUTIONS

Expenses – Functional Classification & Reporting

- What's Required – Functional Classifications
 - Clear understanding of functional classifications
 - **Program services** – the activities that result in goods and services being distributed to beneficiaries, customers, or members that fulfill the purposes or mission for which the NFP exists
 - **Supporting activities** – all activities of a NFP other than program services (management & general, fundraising, membership development)



PEOPLE | IDEAS | SOLUTIONS

Expenses – Functional Classification & Reporting

- What's Required – Functional Classifications
 - Program Expenses
 - Determine the organization's major activities to carry out its mission
 - Includes both direct and indirect expenses
 - Management & General Expenses
 - Relate to the *overall direction* of the organization
 - Not directly identifiable with a specific program, not fundraising
 - Includes oversight, business management, financial reporting, human resources



PEOPLE | IDEAS | SOLUTIONS

Expenses – Functional Classification & Reporting

- What's Required – Functional Classifications
 - Fundraising Expenses
 - Activities that involve inducing donors to contribute assets, service, or time
 - Membership Development Activities
 - Activities that solicit for prospective members and membership dues, membership relations, and similar activities
 - If no significant benefits are provided in exchange for membership dues, the activities are considered fundraising



PEOPLE | IDEAS | SOLUTIONS

Expenses – Functional Classification & Reporting

- What's Required
 - Accounting for Expenses by Function
 - Direct Identification
 - Specifically identified/assigned
 - Preferred method
 - Cost Allocation
 - Direct identification is impossible or impracticable
 - Methodologies should be
 - Rational & systematic
 - Reasonable
 - Consistently applied



PEOPLE | IDEAS | SOLUTIONS

Cost Allocation



PEOPLE | IDEAS | SOLUTIONS

Cost Allocation

- Objectives
 - To apportion shared expenses or shared costs across functional areas
 - To ensure that all costs benefitting a final cost objective are accounted for
 - Performed accurately and consistently, it will provide a realistic picture of what different programs and other activities cost
 - Documented in writing, supported, approved, and applied consistently



PEOPLE | IDEAS | SOLUTIONS

Cost Allocation

- The “Basics”
 - Direct Costs – Directly tied to a purpose or function; unique & exclusive to the activity
 - Indirect Costs – Costs that are shared resources used by the entire organization; common costs
 - Indirect Cost Pool – Grouping of indirect costs that must be allocated
 - Cost driver – Criterion upon which a cost pool is allocated



PEOPLE | IDEAS | SOLUTIONS

Cost Allocation

- Cost Drivers
 - Reasonable
 - Common element to all activities
 - Examples: Headcount, square footage, total direct expenses
 - Logical
 - Direct & proportional
 - Based on efforts & cost of the activity itself, not the outcome
 - Example: Payroll based on effort expended on activity



PEOPLE | IDEAS | SOLUTIONS

Cost Allocation

- Cost Drivers
 - Defensible
 - Results are fair & consistent
 - Results can be duplicated
 - Methodology is documented
 - Best Practices
 - Keep it simple – use the same driver for multiple items
 - Be consistent – same driver, same methodology, every year



PEOPLE | IDEAS | SOLUTIONS

Cost Allocation

- Allocation Methodologies
 - Variety of bases & methods
 - Objective methods preferred over subjective methods
 - Based on financial or nonfinancial data
 - Based on underlying relational concepts
 - Most commonly used are space-related and time-related



PEOPLE | IDEAS | SOLUTIONS

Cost Allocation

- Allocation Methodologies
 - Several aspects based on estimates made by management – need to consider:
 - Appropriate identification of costs
 - Allocation method is appropriate
 - Estimates produce reasonable results
 - Biases in allocations
 - Appropriate supporting documentation
 - Should never be based on achieving certain ratios



PEOPLE | IDEAS | SOLUTIONS

Cost Allocation

- Optimize the Allocation Process
 - Clear documentation – methodologies, cost drivers, and supporting documentation
 - Consistent application
 - Update for changes in cost structure or operating facts & circumstances
 - Analytically review functional classifications by comparing current period to prior period
 - Explain significant variances and/or the lack of expected variances



PEOPLE | IDEAS | SOLUTIONS



Questions?

Kreischer
Miller

PEOPLE | IDEAS | SOLUTIONS

***Thank you
for your participation!***

**Kreischer
Miller**

PEOPLE | IDEAS | SOLUTIONS

Contact the Presenter



Elizabeth F. Pilacik, CPA
Director, Audit & Accounting
epilacik@kmco.com

Elizabeth's experience in auditing and consulting includes serving a wide variety of not-for-profit and tax-exempt organizations, including social service organizations, cultural organizations, membership associations, and private foundations. She is experienced in performing audits in accordance with certain federal, state, and local requirements, as well as engagements requiring certain compliance and programmatic reporting.



PEOPLE | IDEAS | SOLUTIONS