

Functional Expense Allocations

Generally Accepted Accounting Principles (GAAP) require the audit report include a “Statement of Functional Expenses.” Form 990 (for those required to file) contains a Statement of Functional Expenses in Part IX. Many “pundits” closely examine an institution’s “SOFE” closely – and sometimes, frankly, ignorantly. Ultimately, institutions should take great care in how they calculate/allocate the components of this statement.

The broad functional expense categories are exemplified by the columns of Form 990, Part IX: Program service expenses; Management and general expenses; Fundraising expenses. The “vertical line items” of a statement of functional expenses are generally referred to as “natural expenses.”

We have historically found it expedient to report our GAAP Statement of Functional Expenses in a manner that closely follows the example of Form 990, Part IX.

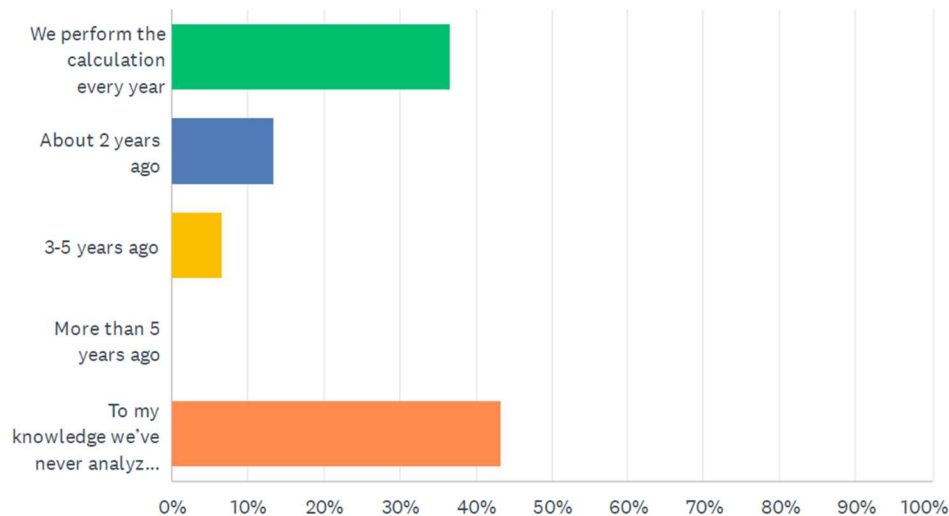
For the most part, the most common methods of allocation for Program, M&G, or Fundraising include Square Footage, Time and Efort, and Full-time Equivalent. The “square footage” methodology is just like it sounds – a “map” of your institution’s usable space (ofices, classrooms, student areas, etc.) broken by percentages of use by each of the three functional categories. Time and efort would include time-tracking of individuals and their various tasks – some might spend 100% of their time in one category, others have a “divided life.” The full-time equivalent method might include the manner of allocating purchased goods and/or services and where those might fit in the three categories (for example, Accounting and Legal expenses, Travel, Food for your cafeteria.)

Functional expense “allocating” is a process/project that should be done regularly. When we polled 30 schools about their frequency of considering this, here is what we found:

Form 990 (2024)		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 <input type="checkbox"/>					
Do not include amounts reported on lines 6b, 7b, 8b, 9b, and 10b of Part VIII.					
	(A)	(B)	(C)	(D)	
	Total expenses	Program service expenses	Management and general expenses	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				
11	Fees for services (nonemployees):				
a	Management				
b	Legal				
c	Accounting				
d	Lobbying				
e	Professional fundraising services. See Part IV, line 17				
f	Investment management fees				
g	Other. (If line 11g amount exceeds 10% of line 25, column (A), amount, list line 11g expenses on Schedule O.)				
12	Advertising and promotion				
13	Office expenses				
14	Information technology				
15	Royalties				
16	Occupancy				
17	Travel				
18	Payments of travel or entertainment expenses for any federal, state, or local public officials				
19	Conferences, conventions, and meetings				
20	Interest				
21	Payments to affiliates				
22	Depreciation, depletion, and amortization				
23	Insurance				
24	Other expenses. Itemize expenses not covered above. (List miscellaneous expenses on line 24e. If line 24e amount exceeds 10% of line 25, column (A), amount, list line 24e expenses on Schedule O.)				
a	_____				
b	_____				
c	_____				
d	_____				
e	All other expenses				
25	Total functional expenses. Add lines 1 through 24e				
26	Joint costs. Complete this line only if the organization reported in column (B) joint costs from a combined educational campaign and fundraising solicitation. Check here <input type="checkbox"/> if following SOP 98-2 (ASC 958-720)				

Q18 How long has it been since your finance team performed a "deep dive" calculation of the amounts shown on your Statement of Functional Expenses (i.e. the percentages for each line item by column)?

Answered: 30 Skipped: 0



It was kind of scary that 43.33% stated, "To my knowledge we've never analyzed this!"

The Form 990 instructions for Part IX can be of value in helping to clarify functional expense allocations. In part, they state...

Column (B)—Program Services Program services are mainly those activities that further the organization's exempt purposes. Fundraising expenses shouldn't be reported as program service expenses even though one of the organization's purposes is to solicit contributions. Include lobbying expenses in this column if the lobbying is directly related to the organization's exempt purposes.

Example. Foundation M, an organization exempt under section 501(c)(3), has the exempt purpose of improving health care for senior citizens. Foundation M operates in State N. The legislature of State N is considering legislation to improve funding of health care for senior citizens. Foundation M lobbies state legislators in support of the legislation. Because this lobbying is directly related to Foundation M's exempt purpose, it would be considered an exempt function expense and would be included under column (B).

Program services can also include the organization's unrelated trade or business activities. Publishing a magazine is a program service even though the magazine contains both editorials and articles that further the organization's exempt purpose as well as advertising, the income from which is taxable as unrelated business income. Also include costs to secure a grant, or contract, to conduct research, produce an item, or perform a program service, if the activities are conducted to meet the grantor's or other contracting party's specific needs. Don't report these costs as fundraising expenses in column (D). Costs to solicit restricted or unrestricted grants to provide services to the general public should be reported in column (D).

Column (C)—Management and General Use column (C) to report expenses that relate to the organization's overall operations and management, rather than to fundraising activities or program services. Overall management usually includes the salaries and expenses of the organization's CEO and his or her staff, unless a part of their time is spent directly supervising program services or fundraising activities. In that case, their salaries and expenses should be allocated among management, fundraising, and program services.

Expenses incurred to manage investments must be reported in column (C). Lobbying expenses should be reported in this column if they don't directly relate to the organization's exempt purposes.

Organizations must also report the following in column (C): costs of board of directors meetings; committee meetings and staff meetings (unless they involve specific program services or fundraising activities); general legal services; accounting (including patient accounting and billing); general liability insurance; office management; auditing, human resources, and other centralized services; preparation, publication, and distribution of an annual report; and management of investments.

However, report expenses related to the production of program-related income in column (B) and expenses related to the production of rental income on Part VIII, line 6b. Rental expenses incurred for the organization's office space or facilities are reported on line 16. Don't use this column to report costs of special meetings or other activities that relate to fundraising or specific program services.

Column (D)—Fundraising. Fundraising expenses are the expenses incurred in soliciting cash and non-cash contributions, gifts, and grants. Report as fundraising expenses all expenses, including allocable overhead costs, incurred in (a) publicizing and conducting fundraising campaigns; and (b) soliciting bequests and grants from individuals, foundations, other organizations, or governmental units that are reported on Part VIII, line 1. This includes expenses incurred in participating in federated fundraising campaigns; preparing and distributing fundraising manuals, instructions, and other materials; and preparing to solicit or receive contributions. Report direct expenses of fundraising events on Part VIII, line 8b, rather than in Part IX, column (D).

However, report indirect expenses of fundraising events, such as certain advertising expenses, in Part IX, column (D), rather than on Part VIII, line 8b. Example. For an employee who works on fundraising 40% of the time and program management 60% of the time, an organization must allocate that employee's salary 40% to fundraising and 60% to program service expenses. It can't report the 100% of salary as program expenses simply because the employee spent over 50% of his time on program management.