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Program Expenses

B5.1 Applicable Authoritative Pronouncements

FASB ASC 958; FASB ASC 958
The Guide, Chapter 13

B5.2 Overview

Expenses should be reported by their functional classification in either a statement of activities or in the notes to the financial statements. Functional classifications include major classes of program services and supporting services. Program services costs are the cost of those activities that are carried out to provide mission-related goods and services to the nonprofit organization's program participants, beneficiaries, or members.

B5.3 Measurement Principles

B5.3.1 Definition of Program Services

Program service activities encompass the purposes or mission for which the nonprofit organization exists; they are the major outputs of the organization. Typically, an organization will have several major programs. SFAS 117, *Financial Statements of Not-for-Profit Organizations* (FASB ASC 958), allows nonprofit organizations to define their major programs and to determine the level at which costs of those programs will be aggregated and disclosed. For example, two organizations may have health and fitness programs for boys and girls. One of these organizations may choose to define its major programs as "health programs" and "fitness programs," while the other organization may define its major programs as "boys' programs" and "girls' programs." This latitude allows organizations to report in ways meaningful to each, presenting information that best describes service efforts and is consistent with internal information systems.

B5.3.2 Examples of Typical Programs

Following are examples of typical programs for certain types of nonprofit organizations.

- Higher Education Programs: student instruction and services, research, public programs, academic support
- Health and Welfare Programs: health or family services, research, prevention, detection and treatment, patient services, public education, general relief, disaster relief
- Cultural Programs: exhibits, performances, productions, community outreach, library, education, curatorial, collections
- Association Programs: membership activities, education, public programs
- Religious Programs: worship services, community outreach, missionary activities, music, children, youth and adult education
- Federated Fundraising Programs: grants and contributions to other organizations

B5.3.3 Classification and Display of Program Expense

All expenses are classified as reductions in unrestricted net assets. When expenses are incurred that meet donor restrictions,

amounts are reclassified from temporarily restricted net assets to unrestricted net assets to indicate the source of funding of these activities.

Nonprofit organizations should provide information about their programs in the financial statements, including a discussion of the nature of the organization's activities and a description of each of the major programs. Notes to the financial statements should disclose total program expense if this total is not evident from the details on the statement of activities.

The number of programs reported by nonprofit organizations will vary according to the nature of the activities performed. Some organizations may report on a single, integrated program. In many cases, however, several separate activities are carried on, and the expenses for each should be reported by the kind of service provided.

FASB ASC 958 specifies that expenses should be reported by *major* classes of programs.

Cost may not be the only measure of what makes up a major program. For example, an organization may have a low-cost, highly effective program that reaches large numbers of program participants. The same organization may have one or a few very costly programs that benefit relatively few participants. Major programs may be determined based on relative numbers of participants served or dollars spent, or other measures of program effectiveness and accomplishments.

Each type of nonprofit organization will have programs that differ from other types of nonprofits, and organizations within each type may have programs that differ from those of the same type. For example, a women's shelter and a food bank are both health and welfare organizations, but their programs differ. The women's shelter may offer counseling, legal, and job location services, while the food bank programs focus on the procurement and distribution of food and other consumables. In addition, nonprofits involved in the same activities may report their programs differently. One organization that provides services to at-risk youths may classify its programs based on the type of activity offered (after-school programs, weekend programs), while another may classify activities based on the age or sex of the individuals helped.

Not-for-profits may enhance information about programs by disclosing the interrelationships of program expenses and their related revenues. For example, a museum might report expenses of special exhibits with revenues from contributions received and fees charged for that exhibit. Related nonmonetary information about program costs and results may also be meaningful to financial statement readers: for example, numbers of visitors to museums, zoos, and other cultural organizations; numbers of applications, acceptances and admissions to educational programs; numbers of individuals counseled, placed in jobs, relocated, fed, or helped by social service organizations. Generally, this information would be reported as supplementary information or as part of management's comments in annual reports.

B5.3.4 Allocation of Expenses Related to More Than One Function

Some expenses relate to more than one program or supporting activity. For example:

- The president or executive director of the organization may be active in programming, in fundraising, and in management and general activities. A proportionate amount of the cost incurred (salary and benefits) performing these activities should be allocated to each.
- The organization's owned or rented facility may be used for programs, for fundraising, and for management and general activities. A proportionate amount of the building cost incurred (utilities, depreciation or rent, insurance, custodial, and maintenance) should be allocated to each activity. If possible, expenses should be directly identified and assigned to the functions for which they were incurred. In some cases, this is a straightforward process, such as when one employee works solely on one program activity. The salary and benefits paid to and other costs incurred by that employee would be assigned to that program. Frequently, however, direct identification and assignment of costs is not possible or practical. In these cases, the expenses should be allocated among the programs and supporting services benefitting from the activity. Allocation techniques are common to all entities, and may be made on a variety of bases. For example, the costs of building occupancy listed above (utilities, depreciation or rent, insurance, custodial, and maintenance) may be allocated to the activities performed based on square footage occupied by each. Costs of key personnel and others who spend significant amounts of time on more than one type of activity may be allocated based on time sheets kept for representative periods during the year. Supplies, copying costs, and postage may be tracked by department and charged to that department's activities. Periodic review and revision of allocation methods and assumptions should be performed, and new allocations should be developed when there are significant changes in

the nature or level of an organization's activities.

Example 1. Expense Allocations

FACTS

Assume Dental Health Clinic provides free or low-cost dental services to low-income individuals. While many duties are performed by volunteers, the clinic has three paid staff:

- Dentist A spends all her time providing dental services to program participants.
- Hygienist B spends 80% of her time providing dental services to program participants and 20% of her time with administrative duties.
- Executive Director C spends 30% of her time providing services to program participants, 50% of her time on administrative matters, and 20% of her time on fundraising.

The clinic is housed in a 1,000-square-foot facility, 800 square feet of which is treatment rooms and waiting areas, while 200 square feet is used for administration.

SOLUTION

Costs of operating the clinic should be functionalized as follows:

- *Program*: Salaries, benefits, and personnel-related expenses: 100% of Dentist A, 80% of Hygienist B, 30% of Executive Director C, 80% of facility costs (depreciation or rent, insurance, custodial and maintenance)
- *Management and General*: Salaries, benefits, and personnel-related expenses: 20% of Hygienist B, 50% of Executive Director C, 20% of facility costs (depreciation or rent, utilities, insurance, custodial and maintenance)
- *Fundraising*: Salaries, benefits, and personnel-related expenses: 20% of Executive Director C

Cost Driver	Salary and Benefits	Allocated to Program	Allocated to Management and General	Allocated to Fundraising
Dentist A	\$125,000	\$125,000	None	None
Hygienist B	\$40,000	\$32,000 ($\$40,000 \times 80\%$)	\$8,000 ($\$40,000 \times 20\%$)	None
Executive Director C	\$60,000	\$18,000 ($\$60,000 \times 30\%$)	\$30,000 ($\$60,000 \times 50\%$)	\$12,000 ($\$60,000 \times 20\%$)
Facility	\$20,000	\$16,000 ($\$20,000 \times 80\%$)	\$4,000 ($\$20,000 \times 20\%$)	None
Total Allocated Cost	\$245,000	\$191,000	\$42,000	\$12,000

Other costs, such as materials and supplies, should be directly traced to cost functions to the extent possible, with the remainder reasonably allocated among the related functions.

B5.3.5 Functionalization of Cost of Goods Sold, Exchange Transaction Expense, and Other Expenses

In determining how to record cost of goods sold and other exchange transaction expense, the nonprofit organization must first determine if the related activity is major and central to the organization, or if it is peripheral and incidental. Major and central activities give rise to revenues and expenses, which must be shown gross on the statement of activities. In addition, the expenses of major and central activities must be functionalized. Peripheral and incidental activities result in gains and losses which may be netted and need not be functionalized.