

Handling Functional Expenses and Developing Indirect Rates:

Best Practices for Effective Nonprofit Financial Operations






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Webinar Objectives

<p>Learning Objective <i>To provide attendees with a better understanding of functional expenses and indirect rates.</i></p>	<p>Instructional Delivery Methods <i>Group Internet-based</i></p>
<p>Recommended CPE <i>1.0 CPE</i></p>	<p>Recommended Fields of Study <i>Auditing</i></p>
<p>Prerequisites <i>None required</i></p>	<p>Advance Preparation <i>None</i></p>
<p>Program Level <i>Basic</i></p>	<p>Course Registration Requirements <i>None</i></p>
<p>Refund Policy <i>No fee is required to participate in this session.</i></p>	<p>Cancellation Policy <i>In the event that the presentation is cancelled or rescheduled, participants will be contacted immediately with details.</i></p>
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Our Team

Meet your instructors



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Agenda

1 | Functional Expense Allocation

2 | Indirect Rates: General

3 | Indirect Rates: Non-federal

4 | Indirect Rates: Federal

5 | Sample Rate Calculation

Allocation of Functional Expenses & Overhead/Indirect Rates

Functional Expense Allocation

- Unique to tax-exempt organizations
- Presents costs on a programmatic and natural expense basis
- Spread costs to programs & donors
- Ratio to program efficiency
- Required for Form 990



The image shows a hand pointing at a digital screen displaying a financial statement table. The table is a balance sheet with columns for three periods. The rows include Cash, Accounts Receivable, Other Current Assets, Total Current Assets, Fixed Assets - Gross, Less: Depreciation, Fixed Assets - Net, Other Assets, Intangible Asset, Total Assets, Accounts Payable, Other Current Liabilities, Total Current Liabilities, Total Liabilities, Compensation, Total Donor Contributions, Total Donor Contributions, Total Equity, and Total Liabilities & Equity.

	2018	2017	2016
Cash	5,044,100	2,855,857	3,268,919
Accounts Receivable	267,487	217,407	334,834
Other Current Assets	83,062	115,183	81,647
Total Current Assets	5,394,649	3,188,447	3,685,399
Fixed Assets - Gross	194,872	271,001	782,300
Less: Depreciation	400,373	330,730	388,616
Fixed Assets - Net	594,500	440,271	393,684
Other Assets	144,950	303,135	316,329
Intangible Asset	261,458	44,839	134,303
Total Assets	6,395,557	3,976,692	4,529,705
Accounts Payable	552,381	438,458	180,189
Other Current Liabilities	288,810	403,218	334,970
Total Current Liabilities	841,191	841,676	515,159
Total Liabilities	841,191	841,676	515,159
Compensation	8,940,794		
Total Donor Contributions	541		
Total Equity	(8,211,322)	(4,707,771)	(5,741,052)
Total Liabilities & Equity	18,985,029	2,794,015	(489,400)

Allocation of Functional Expenses & Overhead/Indirect Rates

Functional Expense Allocation

What to Allocate:

Your organization should clearly define which expense accounts (from chart of accounts) are defined as **Direct Costs: Specific to a particular program or objective** versus **Indirect Costs: costs used by multiple activities**. Once the natural expense categories are defined, the organization should identify those indirect costs that should be allocated.

Presentation:

The two most common presentation methods for allocating expenses are either shown ***above the line*** by natural expense category, or alternatively, the allocation can be done in one lump sum ***below the line***, as shown in the examples to follow.

Allocation of Functional Expenses & Overhead/Indirect Rates

Functional Expense Allocation



Salaries

Most common basis for allocation is the after-the-fact determination of actual time spent working on programs.



Other Bases

Other bases for allocation can include rent & square footage, participants served by program, usage, employees, and more.



Actual vs. Estimates

For those organizations that do not receive federal funding, the basis for allocation may be an estimated amount.

Allocation of Functional Expenses & Overhead/Indirect Rates

Statement of Functional Expenses

	2017				2016	
	Program Services			Supporting Services		Total Expenses
	Civic Health Index	National Conference	Total Program Services	Management and General	Total Expenses	
Salaries and benefits	\$ 165,776	\$ 64,806	\$ 230,582	\$ 116,638	\$ 347,220	\$ 696,469
Consultants and professional fees	51,856	57,525	109,381	30,155	139,536	1,494,736
Program events and publications	3,153	139,254	142,407	302	142,709	154,319
Travel	448	33	481	13,366	13,847	44,748
Supplies	258	14	272	8,230	8,502	20,744
Office operations	20,702	12,837	33,539	17,103	50,642	49,028
Rent and utilities	34,000	15,236	49,236	28,652	77,888	245,144
Bad debt	-	-	-	-	-	2,500
TOTAL	\$ 276,193	\$ 289,705	\$ 565,898	\$ 214,446	\$ 780,344	\$ 2,707,688

Allocation of Functional Expenses & Overhead/Indirect Rates

	Supporting Services			Total Supporting Services	Total Expenses
	Program Services	Management and General	Fundraising		
Employee salaries and benefits	\$ 7,648,954	\$ 695,821	\$ 411,331	\$ 1,107,152	\$ 8,756,106
Field study	244,079	-	-	-	244,079
Contractors/partnerships	367,260	-	-	-	367,260
Program and research consultants	366,699	10,000	3,960	13,960	380,659
Other professional fees	29,697	284,546	57,600	342,146	371,843
Travel	556,815	21,106	7,465	28,571	585,386
Outreach activities	21,626	16,632	-	16,632	38,258
Meetings and conferences	162,033	12,602	19,213	31,815	193,848
Printing and production	225,256	3,349	6,235	9,584	234,840
Supplies and materials	112,943	131,577	9,169	140,746	253,689
Postage and shipping	7,623	3,490	321	3,811	11,434
Furnishings, equipment and software	1,603	95,624	605	96,229	97,832
Rent and utilities	3,051	334,049	16	334,065	337,116
Depreciation and amortization	-	816,787	-	816,787	816,787
Investment fees	-	29,607	-	29,607	29,607
Interest, taxes and condo maintenance fees	-	879,841	-	879,841	879,841
Other	4,589	486,457	1,241	487,698	492,287
Subtotal	9,752,228	3,821,488	517,156	4,338,644	14,090,872
Overhead allocation	1,779,350	(1,856,924)	77,574	(1,779,350)	-
TOTAL	\$ 11,531,578	\$ 1,964,564	\$ 594,730	\$ 2,559,294	\$ 14,090,872

Polling Question #1

Have your functional allocation methodologies been reviewed for reasonableness in the last 1-3 years?

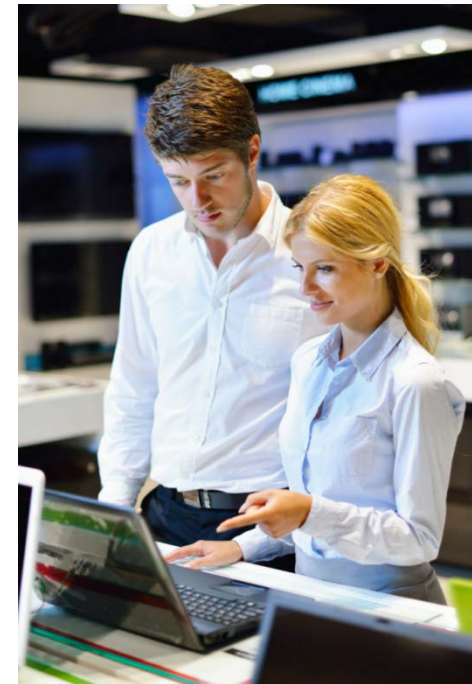
- a. Yes*
- b. No, but they have been reviewed before*
- c. No, and they haven't been reviewed before*

Allocation of Functional Expenses & Overhead/Indirect Rates

Indirect Rates: General

Importance of Allocations & Indirect Rates:

- Ability of management to identify all program costs including allocation of administrative costs; presents the full costs of all programs administered by the nonprofit entity
- Management makes more informed decisions
- Presentation of ratios for donors and outside readers
- Recover donor funds for administrative costs
- Allocate costs equally to all programs



Allocation of Functional Expenses & Overhead/Indirect Rates

Indirect Rates: General

What is the “proper” rate for your organization?

- Public perception vs. reality
- Is the rate too low?
- Is the rate too high?



Allocation of Functional Expenses & Overhead/Indirect Rates

Indirect Rates: Non-federal



Foundations



Foreign Governments



Capped Rates



Actual Organizational Rate



More costs as direct costs?

Polling Question #2

Does your organization currently have a Negotiated Indirect Rate Agreement (NICRA)?

- a. Yes*
- b. No*
- c. What's a NICRA?*

Allocation of Functional Expenses & Overhead/Indirect Rates

Indirect Rates: Federal

Preparation of Indirect Rates in Accordance with U.S. Government Standards

- Title 2 CFR 200 Uniform Administrative Requirements, Cost Principles and Audit Requirements for Federal Awards (Uniform Guidance)

Applicability of Uniform Guidance

- Who is covered?
- What USG awards are covered?



Allocation of Functional Expenses & Overhead/Indirect Rates

Indirect Rates: Federal

Appendix IV – Indirect Costs Identification and Assignment, and Rate Determination for Nonprofits

Allowability

Determining allowability of costs in both the direct base and indirect cost pool

Reasonableness

As with all federal activities, evaluating the reasonableness of costs, methodology and application

Consistency

Consistency is both the treatment of costs as well as the application of the indirect rate

Allocability

Evaluating the ability and accuracy of costs to be allocated, and the respective basis for allocation

Allocation of Functional Expenses & Overhead/Indirect Rates

Indirect Rates: Federal

Types of Rates

NICRA (Provisional final) – Chicken and egg syndrome?	De Minimis 10% (Section 200.414)
Predetermined	Fixed

Allocation of Functional Expenses & Overhead/Indirect Rates

Indirect Rates: Federal

Simplified Method

Where an organization's major functions benefit from its indirect costs to approximately the same degree and where an organization has only one major function encompassing a number of individual projects and federal is a small amount. Indirect costs are spread over an equitable distribution base.

Multiple Allocation Base

Where an organization's major functions benefit from its indirect costs to varying degrees. Indirect costs are accumulated into separate cost groupings and each grouping is allocated individually to programs by means of a base that best measures the relative benefits.

Direct Allocation Method

Some organizations treat all costs as direct costs except general administration and general expenses. Joint costs, such as depreciation, rental costs, operation and facilities are prorated individually as direct costs to each category and to each federal award using a base most appropriate to the cost being prorated.

Allocation of Functional Expenses & Overhead/Indirect Rates

Indirect Rates: Federal



Defining Elements of Cost

- Total costs per financial statements (audit report)
- Defining total direct costs
- Defining total indirect costs

Selected items of cost

1. Salaries and related benefits
2. Occupancy costs
3. Sub-grants and sub-awards
4. Equipment and other capital expenditures
5. Travel costs

Allocation of Functional Expenses & Overhead/Indirect Rates

Indirect Rates: Federal

Selected items of cost (typical unallowable costs)

1. Advertising
2. Bad debt expense
3. Contingencies/provisions
4. Donations and contributions
5. Entertainment (alcoholic beverages)
6. Fines and penalties
7. Interest



Allocation of Functional Expenses & Overhead/Indirect Rates

Indirect Rates: Federal

- Treatment of fundraising costs
- Treatment of lobbying expenditures
- Other adjustments



Polling Question #3

Does your organization have definitions and policies in place to be able to properly calculate indirects?

- a. Yes*
- b. No*
- c. Not yet*
- d. I don't know*

Allocation of Functional Expenses & Overhead/Indirect Rates

Sample Rate Calculation

Direct Cost Base

1. Total program service expense
2. Total fundraising expense
3. Adjustments
 1. Unallowable expenses
 2. Grants and contracts in excess of \$25,000
 3. Reallocation of administrative costs
 4. Equipment and capital expenditures

Total allowable direct costs

Indirect Costs

1. Total management and general expenses
2. Adjustments
 1. Unallowable costs
 2. Lobbying expenditures
 3. Reallocation of administrative costs

Total allowable indirect costs

Allocation of Functional Expenses & Overhead/Indirect Rates

Sample Rate Calculation

Total Direct Expenses			
Total program service expenses	60,000,000		
Total Fundraising expenses	2,000,000		
	62,000,000		
Adjustments:			
Unallowable expenses	50,000		
Grants and contracts in excess of \$25,000	(12,000,000)		
Equipment and Capital Expenditures	(1,000,000)		
Total Allowable Direct Expenses	49,050,000		
Total Indirect Expenses			
Total Management and General expenses	8,000,000		
Adjustments:			
Unallowable expenses	(200,000)		
Total Allowable Indirect Expenses	7,800,000		
		Indirect Rate Calculation:	
		Total Allowable Indirect Expenses	7,800,000
		Total Allowable Direct Expenses	49,050,000
			15.90%



Questions?

We'd like to hear from you!

Get In Touch



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