PacificCPE

COURSE
33755A

Tax-Exempt Orgs: Functional Expenses, Balance Sheet, and Net Assets

Accurate financial reporting is at the heart of Form 990 compliance, and this course covers three key financial statements. You'll explore the Statement of Functional Expenses, learning how to allocate costs across program, management, and fundraising functions. The course also addresses the Balance Sheet and the Reconciliation of Net Assets, giving you the tools to ensure these sections are completed correctly and consistently. A must for practitioners involved in nonprofit financial reporting and year-end preparation.

CREDIT HOURS 2 | FIELD OF STUDY TAXES | EXAM QUESTIONS 10

Start Course ↓ | Final Exam Copy ↓

LEARNING ASSIGNMENTS AND OBJECTIVES

Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course Objectives

- Identify types of expenses that must be included in the Statement of Functional Expenses.
- Identify balance sheet requirements of Part X.
- Identify reporting requirements for the method of accounting and allocation used in completing the Form 990.

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Chapter 1: STATEMENT OF FUNCTIONAL EXPENSES (PART IX OF FORM 990)

Chapter Objective

After completing this chapter, you should be able to:

- Identify types of expenses that must be included in the Statement of Functional Expenses.

I. OVERVIEW

Part IX of Form 990 asks organizations to provide a statement of functional expenses. Use the organization's normal accounting method to complete this section. If the organization's accounting system does not allocate expenses, the organization may use any reasonable method of allocation. The organization must report amounts accurately and document the method of allocation in its records. Report any expense described in Lines 1-23 in the appropriate line; do not report such expense in Line 24. Do not report in Part IX expenses that must be reported on Lines 6b, 7b, 8b, 9b, or 10b in Part VIII.

II. SPECIFIC INSTRUCTIONS

COLUMN (A)

Section 501(c)(3) and 501(c)(4) organizations must complete columns (A) through (D).

All other organizations must complete column (A) but can complete columns (B), (C), and (D).

State reporting requirements can be different from IRS reporting requirements applicable to Part IX.

COLUMN (B)

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 in column (B).

Program services can also include the organization's unrelated trade or business activities. For example, 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.

Include costs to secure a grant, or contract, to conduct research, produce an item, or perform a 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)

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 chief executive officer 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 in Part VIII, on 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 expenses are the expenses incurred in soliciting 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 Line 1 in Part VIII. 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 column (D) of Part IX. However, report indirect expenses of fundraising events, such as certain advertising expenses, in column (D) of Part IX, rather than on Part VIII, line 8b.

Example

For an employee who works on fundraising 40 percent of the time and program management 60 percent of the time, an organization must allocate that employee's salary 40 percent to fundraising and 60 percent to program service expenses. It cannot report the 100 percent of salary as program expenses simply because the employee spent over 50 percent of his time on program management.

A. ALLOCATING INDIRECT EXPENSES

Direct costs are expenses that can be identified specifically with an organization's activity or project, and can be assigned to an activity or project with a high degree of accuracy. Indirect costs are costs that can't be identified specifically with an activity or project. For example, a computer bought by a university specifically for a research project is a direct cost. In contrast, the costs of software licensing for programs that run on all the university's computers are indirect costs.

Colleges, universities, hospitals, and other organizations that incur indirect expenses in various cost centers (such as organizational memberships, books and subscriptions, and regular telecommunications costs) may allocate and report such expenses in the following manner:

1. Report the expenses of all indirect cost centers in Column (C) of Lines 5 through 24; and
2. As a separate line item of Line 24, enter “Allocation of [name of indirect cost center] expenses.”

a) If any of the cost center’s expenses are allocated to expenses listed in Part VIII, such as the expenses attributable to fundraising events and activities, enter such expenses as a negative figure in Columns (A) and (C);

b) Allocate expenses to Column (B) or (D) as positive amounts; and

c) Add the amounts in Columns (B) and (D) and enter the sum as a negative offsetting amount in Column (C). Don’t make any entries in Column (A) for these offsetting entries.

Example

An organization reports in Column (C) $50,000 of its actual management and general expenses and $100,000 of expenses of an indirect cost center that are allocable in part to other functions. The total of Lines 5-24 of Column (C) would be $150,000 before the indirect cost center allocations were made. Assume that of the $100,000 total expenses of the cost center, $10,000 was allocable to fundraising; $70,000 to various program services; $15,000 to management and general functions; and $5,000 to special events and activities. To report this in Part IX under this optional method:

1. Indicate the cost center, the expenses of which are being allocated, on Line 24, as “Allocation of [specify the indirect cost center] expenses;
2. Enter a decrease of $5,000 on the same line in the Column (A), “Total expenses,” representing the fundraising event expenses that were already reported in Part VIII, Line 8b;
3. Enter $70,000 on the same line in Column (B), “Program Service expenses”;
4. Enter $10,000 on the same line in Column (D), “Fundraising Expenses”; and
5. Enter a decrease of $85,000 on the same line in Column (C), “Management and general expenses,” to represent the allocations to functional areas other than management and general.

Line	(A)	(B)	(C)	(D)
5-24a	$150,000	--	$150,000	--
24b Allocation of $100,000 indirect cost center expenses reported in (C)	(5,000)	70,000	(85,000)	10,000
25	$145,000	$70,000	$65,000	$10,000

After making these allocations, the Column (C), Line 25, total functional expenses, would be $65,000, consisting of the $50,000 actual management and general expense amount and the $15,000 allocation of the aggregate cost center expenses to management and general.

The above is an example of a one-step allocation that shows how to report the allocation in Part IX. This reporting method would actually be more useful to avoid multiple-step allocations involving two or more cost centers. Without this optional reporting method, the total expenses of the first cost center would be allocated to the

other functions, and might include an allocation of part of these expenses to another cost center. The expenses of the second cost center would then be allocated to other functions and, perhaps, to other cost centers, and so on. The greater the number of these cost centers that are allocated out, the more difficult it is to preserve the object classification identity of the expenses of each cost center (for example, salaries, interest, supplies, etc.). Using the reporting method described above avoids this problem.

Note

The intent of the above instructions is only to facilitate reporting indirect expenses by both object classification and function. These instructions don’t authorize the allocation to other functions of expenses that should be reported as management and general expenses.

B. GRANTS AND OTHER ASSISTANCE TO GOVERNMENTS, ORGANIZATIONS, AND INDIVIDUALS

Organizations should report the amount of grants and other assistance on lines 1 through 3. Report expenses incurred in selecting recipients or monitoring compliance with the terms of a grant or award on lines 5 through 24.

Note

Organizations can report this information according to ASC 958 but aren’t required to do so. For example, an organization that follows ASC 958 and makes a grant during the tax year to be paid in future years should report the grant’s present value on this year’s Form 990 and report accruals of additional value increments in future years.

Line 1. Enter the amount that the organization, at its own discretion, paid in grants to domestic organizations and domestic governments. United Way and similar federated fundraising organizations should report grants to member or participating agencies on line 1. Organizations must report voluntary grants to state or local affiliates for specific (restricted) purposes or projects on line 1.

If the organization reported on line 1 more than $5,000 of grants or other assistance to any domestic organization or to any domestic government, the organization must complete Parts I and II of Schedule I (Form 990).