Are Your Cost Allocations Up-to-Date?

You should review your methods at least once a year. Here's what you need to know.

By Colleen Williams

As your nonprofit organization adds or eliminates new programs or activities, do you review your expense methodology? It's essential that you review and update your allocation process on a regular basis.

To help users of your financial statements assess your organization's service efforts, you need to report expenses by functional classification, such as major classes of program services (that is, the central purposes and output of the organization) and supporting services (which include all other activities and are generally divided into three categories):

> Be sure to apply the allocation method consistently.

- **management and general:** oversight, administration, and financial management
- **fundraising:** all activities related to soliciting contributions and raising funds for the organization
- **membership development:** all activities related to soliciting new members and maintaining records on new members.

Costs directly related to a program or supporting service should be charged completely to that program or service. If the costs don't precisely connect to a specific service, they should be allocated between the applicable classifications.

> Review each expense line to determine the appropriate distribution process.

Review each expense line to determine the appropriate distribution process. You can use different systems for different types of expenses. You might, for example, allocate salaries and fringe benefits based on time sheets. You might bill office rent and building expenses based on a square footage calculation. And office supplies might be dispensed based on consumption records. Just be sure the allocation method is rational and systematic, results in a reasonable distribution of costs, and is applied consistently.

If your organization has "joint activities" in which it incurs program, management, and general costs in activities that also include fundraising expenses, follow the guidance in Statement of Position (SOP) 98-2, "Accounting for Costs of Activities of Not-for-Profit Organizations and State and Local Governmental Entities that Include Fund Raising." If any of the criteria of purpose, audience, and content — as defined in the SOP — aren't met, you should report all spending of the joint activity as fundraising expenditures. However, costs of goods or services provided in exchange transactions — that are part of joint activities, such as expenses of direct donor benefits of a special event (for example, a meal) — shouldn't be reported as fundraising.

Whatever method your organization chooses, it's important to review it at least once a year. And be sure to document this process and make it available to your auditors to review as part of your annual audit. ■

Resources

Harr, David & Robert Frank, "New Rules for Reporting Fundraising Costs," *Nonprofit World*, Vol. 16, No. 6.

Little, H. Breckenridge, "Analyze Your Finances to Ensure Your Mission," *Nonprofit World*, Vol. 19, No. 5.

O'Reilly-Allen, Margaret, "How to Have an Audit without Breaking the Bank," *Nonprofit World*, Vol. 20, No. 4.

Solloway, Richard, "Don't Forget Your Indirect Costs!", *Nonprofit World*, Vol. 14, No. 5.

These resources are available at www.snpo.org/members.

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