TREC TOGETHER RISING AS AN ENVIRONMENTAL COMMUNITY

TREC FISCAL MANAGEMENT RESOURCE

Putting Expenses in the Right Place

These instructions are a companion piece to the TREC Shared Allocation toolkit.

Introduction

For U.S. based organizations, the IRS form 990 requires you break out your expenses into three functional expense categories: Program Services, Management and General, and Fundraising.

Although this is a practice all nonprofits must do, many fail to classify their expenses accurately. It's not uncommon for organizations to allocate too many expenses to Fundraising and Management & General, and not enough to Program Services.

The IRS requires organizations to present their financials in this way for transparency purposes. Doing so provides insight into how the organization's funds are being spent. This information is seen by donors, foundations, and potential donors. With websites such as GuideStar.org, this level of scrutiny is increasing.

Not allocating functional expense correctly results in an inaccurate representation of the organization's expenses to the public. Furthermore, not allocating expenses correctly results in a misunderstanding internally regarding the full costs of an organization's programs. Properly allocating functional expense helps guide strategic decisions by knowing the full costs of programs. It can also lead to better grant writing and more accurate allocation of indirect expenses.

Below we discuss these three functional expense areas and how to determine what qualifies for each.

Note: For our purposes we will be using the terminology from the IRS form 990 to label the three functional expense categories: Program Services, Fundraising, and Management and General. The Management and General category is sometimes also referred to as Administration or Admin.

The Three Areas

Use Narrow Definitions for Non-Program Service Areas
Use narrow (and accurate) definitions of Management and General and Fundraising. The IRS instructions for the form 990 defines the three functional expense areas as follows:

- "**Program Services** are mainly those activities that further the organization's exempt purposes."
- "**Fundraising expenses** are the expenses incurred in soliciting cash and noncash contributions, gifts, and grants."
- "**Use 'Management & General'** to report expenses that relate to the organization's overall operations and management."

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The instructions go further by breaking down the specifics of each functional area. They emphasize the narrow definition of Fundraising and Management & General.

Fundraising

Fundraising is narrowly defined as the activity of soliciting funds. Therefore, activities such as grant writing can be broken out. Staff should separate their time developing program strategy prior to writing a grant proposal. They could produce a program plan which is used for other purposes besides fundraising (educating the board, baseline document for other publications, website, etc.). That time, and the associated expenses for that work, can be counted as Program Services. The time spent writing a grant proposal is Fundraising. If the program strategy is clear before you start the grant proposal, then the time spent on fundraising is more efficient.

Program staff can be commended for how their work supports fundraising efforts by attending events, doing public education, public outreach, writing up program plans, etc. But that time does not fit the narrow definition of Fundraising. These things have other purposes like building the organization's reputation, educating and mobilizing the public, etc. Therefore this is a Program Services expense.

Creating a newsletter is not considered fundraising if it's not directly soliciting funds. If it's part of the exempt purpose of educating the public, it is considered a Program Services expense.

Management and General

Management and General is for activities that "relate to the organization's overall operations and management". This includes preparing financial statements, filing your 990, and doing an audit. This is administration for the overall organization, not in service of just one program. Managing a specific program counts as a Program Service expense for that program.

Generally, just the Executive Director and Administrative staff bill to the Management and General category – unless you have farmed out some of this work to other staff. But don't let Management and General be a "catch all" for administrative staff. Time spent on preparing payroll, accounts payable, office managing, can all be spread between program areas.

"Don't let Management/General be a "catch all" for administrative staff."

You work with the Board in various programmatic ways, but Board work is usually all captured under Management and General because of the supremacy of their fiduciary role– except when working with them on a fundraising campaign. That would be fundraising.

Program Services

As you can see from the narrow definitions of the Fundraising and Management & General functions, Program Services is where the majority of your allocation will be. Unless the expense or activity fits into these narrow definitions, it belongs in Program services.

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Program staff, generally, do not allocate time to Management and General.Time spent doing their to-do list, filing, answering email is often mis-labeled as administration because it is administrative type of work. This work belongs in Program Services. Each program staff should have a “home” program area where they bill this general time.

Conclusion

Allocating functional expenses in this way is not a manipulative technique to “paint a better picture” of your financials. It’s quite the opposite. By categorizing functional expense correctly, you’re showing the full costs of your programs. These are accurate accounting techniques in accordance with the Generally Accepted Accounting Principles (GAAP).

When you decide how to allocate something make sure it passes the reasonable test. You can slip a note into a file which documents how you made your decision. You can also write up your allocation policy and have that available for review by auditors.

Having a narrow definition of Fundraising and Management and General helps you to accurately represent the true costs of your programs. This benefits your organizations, your funders, and the mission you serve.

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