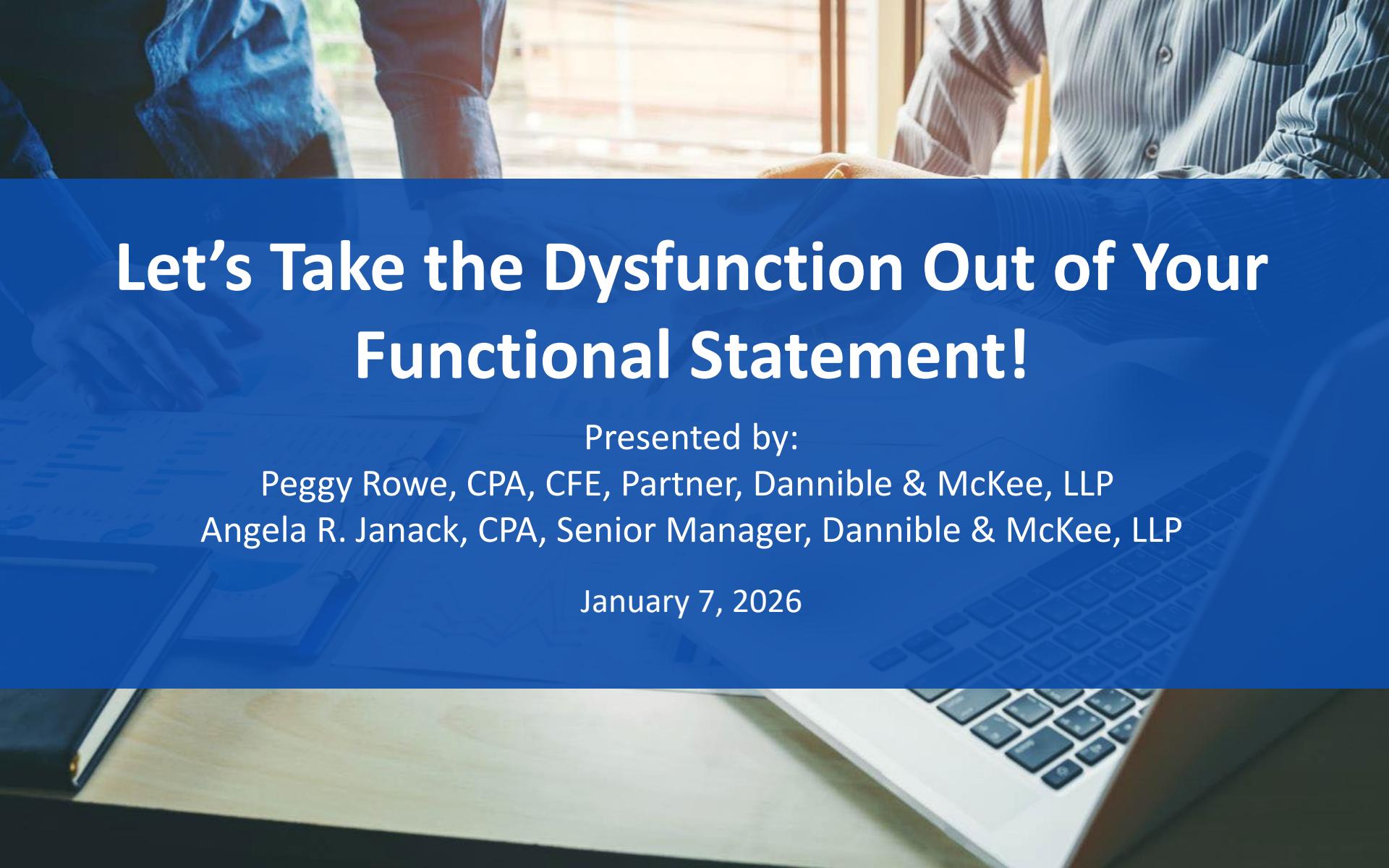




Delivering Confidence



Let's Take the Dysfunction Out of Your Functional Statement!

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.... Outline

- Functional expenses:
 - Who?
 - What?
 - Why?
 - How? (Direct Identification or Allocations)
- Allocation Methods
- How to Track Expenses
- Common Pitfalls
- Best Practices

Who, What, Why and How of Functional Expenses

.... **Who?**

All not-for-profits must follow the AICPA accounting guidance on Functional expenses including but not limited to:

- Charitable Organization 501(c)(3)s
- Non-profit healthcare entities
- Churches and religious organizations
- Private Foundations
- Other non-profits

....

What is a Statement of Functional Expenses?

- Your Functional Statement presents your allocated costs to the readers of your financial statements.
- “Function” defines the purpose or activity an expense supports, typically categories such as
 - Program Services
 - Management and General and
 - Fundraising
- Nature or Natural Classification
 - Refers to the intrinsic type or substance of a cost
 - Examples include salaries, rent, depreciation, office supplies, etc.

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Presentation of Statement of Functional Expenses

Your Functional Statement may be presented:

- 1) On the face of the Statement of Activities;
- 2) In the notes to the financial statements; or
- 3) As its own statement in the face of the financial statements

Note: Including the Statement of Functional Expenses as a Supplemental Schedule to the Financial Statements does not meet the reporting requirement.

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Presentation of Statement of Functional Expenses – cont.

Your Functional Statement may be presented:

- 1) Comparative OR
- 2) With Prior Year Summarized totals

Note: If only presenting prior year summarized totals, the notes should indicate that the statements should be read in conjunction with the prior audited financial statements from which the information is derived.

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Exceptions and Special Considerations

Nearly all expenses should be included in the statement of functional expenses as program, management and general, or fundraising, with a few exceptions.

- Investment expenses
- Gains and Losses
- Cost of Goods Sold
- Costs of Direct Benefits to Donors

.... **Investment Expenses**

External and direct internal investment expenses that have been netted against investment return should not be included in the analysis of expenses by nature and function.

....

Gains and Losses

Certain items that are typically excluded from net income of for-profit entities, such as those items listed in FASB ASC 220-10-45-10A, are considered gains or losses and, like other gains and losses, should not be included in the analysis of expenses by nature and function.

Examples

- Gains and losses on investments
- Gains and losses on foreign currency adjustments
- Gains and losses on postretirement benefit obligations

.... Cost of Goods Sold

Per [FASB ASC 958-720-45-20](#), the way that costs related to sales of goods and services are displayed depends on whether the sales constitute a major or central activity of the NFP or a peripheral or incidental activity.

- For example, a not-for-profit museum that has a store that is a major or central activity should report and display separately the revenues from the store's sales and the related cost of sales. Cost of sales is permitted to be reported immediately after revenues from sale of merchandise, and may be followed by a descriptive subtotal, or cost of sales may be reported with other expenses.
- If the store sells merchandise that is related to the museum's program, the store would be a program service and the cost of the store's sales would be reported as a program expense.
- In other circumstances, cost of sales could be reported as a separate supporting service. For example, if operating a cafeteria is a major or central activity but is not related to the NFP's programs, the cafeteria's cost of sales would be reported as supporting services.

.... Direct Benefits to Donors

- As discussed in Q&A section 6140.08, "Functional Category of the Costs of **Direct Donor Benefits**," the costs of donor **benefits** that are not program related should be reported as a separate supporting category, such as cost of sales, if the **benefits** are provided in exchange transactions; they should not be reported as fundraising.
- If the donor **benefits** are provided in transactions that are not exchange transactions, such as a fundraising dinner for which there is no charge to attend, the costs of donor **benefits** should be reported as fundraising unless they are program related.
- Some NFPs conduct joint activities that are special events, such as symposiums, dinners, dances, and theater parties, in which the attendee receives a **direct benefit** (for example, a meal or theater ticket) and for which the admission price includes a contribution. In this case, the contribution revenue is shown net of the expense that was a direct benefit.

Direct Benefits to Donors – Examples

Case A	Case B	Case C
Changes in net assets without donor restrictions:	Changes in net assets without donor restrictions:	Changes in net assets without donor restrictions:
Contributions \$200	Revenues: Contributions \$200	Contributions \$270
Special event revenue <u>100</u>	Special event revenue <u>100</u>	Dinner sales 30
Less: Costs of direct benefits to donors <u>(25)</u>	Total revenues <u>300</u>	Less: Costs of direct benefits to donors <u>(25)</u>
Net revenues from special events <u>75</u>	Expenses: Program 60	Gross profit on special events 5
Contributions and net revenues from special events <u>275</u>	Costs of direct benefits to donors 25	Contributions and net revenues from special events <u>275</u>
Other expenses:	Management and general 20	Other expenses: Program 60
Program 60	Fund-raising 35	Management and general 20
Management and general 20	Total other expenses <u>140</u>	Fund-raising 35
Fund-raising <u>35</u>	Increase in net assets without donor restrictions <u>\$160</u>	Total other expenses <u>115</u>
Total other expenses <u>115</u>		Increase in net assets without donor restrictions <u>\$160</u>
Increase in net assets without donor restrictions <u>\$160</u>		

Statement of Functional Expense Example

	Program Services			Management and General	Fundraising and Development	Cost of Direct Benefits to Donors	20CY	20PY
	Animal Care	Education and Outreach	Total					
Salaries and wages	\$ 630,000	\$ 480,000	\$ 1,110,000	\$ 342,000	\$ 183,000	\$ -	\$ 1,635,000	\$ 1,708,000
Animal food and supplies	362,000	-	362,000	-	-	-	362,000	340,000
Employee benefits	98,000	72,000	170,000	51,000	28,000	-	249,000	256,000
Payroll taxes and fees	48,000	37,000	85,000	27,000	14,000	-	126,000	127,000
Professional services	20,000	-	20,000	49,000	50,000	-	119,000	40,000
Grants	-	100,000	100,000	-	-	-	100,000	80,000
Printing and postage	2,000	34,000	36,000	28,000	9,000	-	73,000	52,000
Meals and entertainment	-	-	-	-	-	69,000	69,000	57,000
Occupancy	36,000	16,000	52,000	10,000	4,000	-	66,000	58,000
Advertising and public awareness	-	35,000	35,000	28,000	-	-	63,000	11,000
Depreciation	33,000	14,000	47,000	8,000	3,000	-	58,000	55,000
Travel	4,000	30,000	34,000	10,000	6,000	-	50,000	43,000
Information technology	3,000	1,000	4,000	22,000	16,000	-	42,000	43,000
Insurance	15,000	8,000	23,000	6,000	3,000	-	32,000	27,000
Interest	7,000	3,000	10,000	2,000	1,000	-	13,000	15,000
Other	3,000	1,000	4,000	9,000	-	-	13,000	11,000
Total expenses by function	1,261,000	831,000	2,092,000	592,000	317,000	69,000	3,070,000	2,923,000
Less expenses included with revenues on the statement of activities	-	-	-	-	-	(69,000)	(69,000)	(57,000)
Cost of direct benefits to donors	-	-	-	-	-	-	-	-
Total expenses included in expense section on the statement of activities	\$ 1,261,000	\$ 831,000	\$ 2,092,000	\$ 592,000	\$ 317,000	\$ -	\$ 3,001,000	\$ 2,866,000

.... Why?

It's required! (GAAP)

- ASU 2016-14 Presentation of Financial Statements of Not-for-Profit Entities requires **not-for profit** entities to report expenses by nature and function.

Transparency!

- Allows readers to understand the impact of their donations.
- Helps grantors to assess the fiscal responsibility of organizations.
- Improves reporting for Board and Management oversight.

IRS Reporting

- Form 990 requires 501(c)(3) and 501(c)(4) organizations to report breakdown of expenses between the three classifications.

.... **How? (Methodology)**

Allocation methods

- Direct identification

OR

- Reasonable allocation

Allocation Methods

.... **Direct Identification**

Direct identification is the preferred method whenever possible and practical.

- Involves allocating actual expenditures incurred related to a specific program, supporting service or grant

....

Reasonable Allocations

- There are times where direct identification is not possible or practical.
- When determining which method, consider factors such as
 - Do costs benefit multiple programs or functions?
 - Do costs of tracking for specific identification exceed benefits?
 - Are total cost categories material?
 - Are costs specifically defined by Accounting Guidance?

....

Reasonable Allocations

- Objective methods of allocating expenses are preferable to subjective methods.
- The allocation may be based on related financial or nonfinancial data.

....

Common Allocation Methods

- Time and effort reporting
 - Timesheets
 - Activity logs
- Headcount or full-time equivalents (FTEs)
- Square footage (for occupancy costs)
- Direct usage or consumption
- Percentage of revenue or transactions processed
- Hybrid or layered allocation approaches

....

Selecting and Applying Allocation Methods

- Matching the method to the nature of the cost
- Consistency across periods
- Documentation of methodology and assumptions
- Periodic reassessment and updates
- Avoiding overly complex or unsupported methods

Common Costs and Allocation Bases			
Cost Category	Examples of Costs	Common Allocation Bases	Notes / Best Practice Considerations
Personnel Costs	Salaries, wages, payroll taxes, benefits	Time and effort reporting; job duty estimates	High audit focus; documentation critical
Occupancy Costs	Rent, utilities, insurance, maintenance	Square footage; headcount by area	Square footage preferred when distinct
Information Technology	Software, hardware, IT support	Users; devices; usage metrics	Reflect actual usage
Professional Fees	Legal, accounting, consulting	Direct assignment; time spent	Avoid allocation if identifiable

Common Costs and Allocation Bases

Cost Category	Examples of Costs	Common Allocation Bases	Notes / Best Practice Considerations
Human Resources	Recruiting, training, HR systems	Headcount; FTEs	Proxy for level of HR support
Finance & Accounting	Accounting staff, audit costs	Transactions processed; time spent	Audit fees often M&G
Executive Management	CEO and leadership costs	Time and effort estimates	Often partially allocable
Depreciation	Furniture, equipment, building depreciation	Asset usage; square footage	Consistent with asset use

Common Costs and Allocation Bases

Cost Category	Examples of Costs	Common Allocation Bases	Notes / Best Practice Considerations
Insurance	Liability, D&O, property insurance	Payroll; headcount; asset values	Match base to risk driver. Example: Professional Liability ins. may be allocated based on employees w/ certifications.
Office Supplies	Supplies, postage	Headcount; transactions	Direct charge when possible

How to Track Expenses

.... **How?**

- Excel
- QuickBooks (QB)
- Other ERP

.... **How? cont.**

Excel

A valid and valuable tool, but manual calculations can be difficult to track. Any time an Organization can utilize programs designed for expense tracking, it minimizes the chance for errors and increases efficiencies.

QuickBooks

Class and Customer functions are great ways to track your functional expenses (common with our clients)

Other ERP Systems

Most systems have some class, project, or similar function. Contact your provider for additional assistance if needed.

....

Internal Expense Tracking

Importance of Internal Expense Tracking

Allows the organization to:

- Properly track expenses among funding sources
- Evaluate programming
- Ensure there is no "double dipping" on expenses for grants
- Makes preparing your Statement of Function Expenditures quick and simple at year end!

....

Internal Expense Tracking, cont.

Statement of Activities: a financial report that shows a nonprofit organization's revenue, expenses, and net income over a specific period of time.

Also known as a "Profit & Loss" in QB

- It is one of the essential financial statements for nonprofits and is crucial for demonstrating how well the organization manages its resources.
- It can help nonprofits categorize their revenue and expenses and identify the need to adjust programming.

....

Internal Expense Tracking, cont.

Statement of Activities by Customer

Also referred to as by " Funding Source"

- Each funding source should be set up as its own "*Customer*"
- Income & Expenses can be allocated to that specific customer



Profit & Loss by Customer or "Funding Source"

	Grant A <i>Cost Reimb.</i>	Grant B <i>Cost Reimb.</i>	General Fund	Grant C <i>Cost Reimb.</i>	Grant D <i>Donor Rest.</i>
<i>Income</i>					
Grant Income	\$ 228,000.00	\$ 20,000.00	\$ 25,000.00	\$ 50,000.00	\$ 10,000.00
Contributions				\$ 120,000.00	
Total Income	\$ 228,000.00	\$ 20,000.00	\$ 25,000.00	\$ 50,000.00	\$ 10,000.00
<i>Expenses</i>					
Salaries	\$ 150,000.00	\$ 20,000.00	\$ 4,000.00	\$ 25,000.00	\$ 5,500.00
Fringe	\$ 28,500.00		\$ 760.00	\$ 4,750.00	\$ 1,045.00
Contracted Services	\$ 12,400.00			\$ 5,250.00	
<i>Enrichment</i>					
Program Supplies	\$ 30,000.00			\$ 15,000.00	\$ 2,425.00
Office Supplies	\$ 200.00			\$ 300.00	
Staff Development	\$ 3,000.00			\$ 1,200.00	
Travel	\$ 1,500.00				
Utilities	\$ 1,200.00			\$ 12,000.00	
Telephone	\$ 450.00			\$ 4,500.00	
Liability Insurance	\$ 750.00			\$ 16,000.00	
Total Expenses	\$ 228,000.00	\$ 20,000.00	\$ 22,760.00	\$ 50,000.00	\$ 8,970.00
Net Income	\$ -	\$ -	\$ 2,240.00	\$ -	\$ 1,030.00

.... Add Customers in QuickBooks

- Go to All apps A bunch of numbers and letters on a tile wall., then Customer Hub, then Customers (Take me there).
- Select New customer.
- In the Customer display name field, enter what you want to display for the customer. (This is a required field)
- Review each section and enter any other important customer info.
- Optional: You can assign customers who are also part of a group or large organization as the sub-customers of an existing “parent” customer. While you can have unlimited sub-customers, parent accounts can only have sub-customers up to four levels deep.
- Select the Is a sub-customer checkbox. This action will display a parent customer dropdown menu.
- In the Parent customer ▼ dropdown, select the parent account.
- If the customer is tax exempt, go to the Additional info section and select the checkbox for This customer is tax exempt. Then, select why they’re tax exempt in the Reason for exemption ▼ dropdown.
- Select Save.

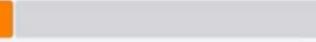
Add Customers in QuickBooks

Customers & leads

Overview **Customers** Marketing

Customers

Customer types **New customer** 

\$78,800	\$0.00	\$412.62	\$747.83	\$1,000
2 estimates	Unbilled income	1 overdue invoice	4 open invoices and credits	1 recently paid
				

Search 

<input type="checkbox"/> NAME	PHONE	OPEN BALANCE	ACTION
<input type="checkbox"/> Shady Oaks Apartments		\$125.00	Receive payment 
<input type="checkbox"/> The Brosnan Club		\$0.00	Create invoice 

....

Internal Expense Tracking, cont.

Statement of Activities by Class

- Also referred to as by " Program"
- Each program should be set up as its own "*Class*", in addition to Fundraising and M&G classes.
- Income & Expenses can be allocated to that specific class



Profit & Loss by Class or "Program"

	Program A	Program B	Program C	Program D	Program E
<i>Income</i>					
Grant Income	\$ 10,000.00	\$ 2,500.00	\$175,000.00	\$ 15,000.00	\$50,000.00
Total Income	\$ 10,000.00	\$ 2,500.00	\$175,000.00	\$ 15,000.00	\$50,000.00
<i>Expenses</i>					
Salaries	\$ 4,000.00	\$ 1,000.00	\$ 95,000.00	\$ 7,500.00	\$30,000.00
Fringe	\$ 760.00	\$ 190.00	\$ 18,050.00	\$ 1,425.00	\$ 5,700.00
Contracted Services			\$ 15,000.00	\$ 2,500.00	\$ 5,000.00
Enrichment	\$ 4,000.00		\$ 5,000.00		
Program Supplies	\$ 2,500.00	\$ 1,310.00	\$ 35,000.00	\$ 3,500.00	\$ 8,000.00
Office Supplies			\$ 250.00		
Staff Development			\$ 1,000.00		
Travel	\$ 750.00		\$ 150.00	\$ 500.00	
Utilities			\$ 1,700.00		
Telephone			\$ 500.00		
Liability Insurance			\$ 750.00		
Total Expenses	\$ 12,010.00	\$ 2,500.00	\$171,650.00	\$ 15,425.00	\$48,700.00
Net Income	\$ (2,010.00)	\$ -	\$ 3,350.00	\$ (425.00)	\$ 1,300.00

.... Add Classes in QuickBooks

For QuickBooks Online

- Enable Class Tracking: Go to Settings  > Account and Settings > Advanced > Categories. Turn on "Track classes" and set it to "One to entire transaction" or "One to each row".
- Create Classes (if needed): Go to Settings  > All Lists > Classes and select New to create your class names (like departments or locations).
- Open the Bill: Open the bill you want to categorize.
- Assign Class: Look for the Class column on the bill (you may need to customize columns) and select the relevant class for each expense line.
- Save: Click Save and close.

Add a Class in QuickBooks Online

Invoice x + qbo.intuit.com/app/invoice?txnid=93

Bookmarks Amazon QuickBooks YouTube

Invoice 1029

Edit Payor view < Invoice 1029 >

Dukes_bbball@intuit.com
Cc/Bcc

Bill to
Peter Dukes
Dukes Basketball Camp
25 Court St.
Tucson, AZ 85719

Invoice no. 1029
Terms Net 30
Invoice date 04/14/2025
Due date 05/14/2025

Edit Customer

Product or service

#	Product/service	Description	Qty	Rate	Amount	Class (hidden)	Tax
1	Design:Fountains:Concrete	Concrete for fountain installation	5	15.00	\$75.00	Select a class	<input checked="" type="checkbox"/> trash
2	Design:Rocks	Garden Rocks	6	12.00	\$72.00	+ Add new	<input checked="" type="checkbox"/> trash
3	Design:Fountains:Rock Fountain	Rock Fountain	1	275.00	\$275.00	General Sales	<input checked="" type="checkbox"/> trash
4						Maintenance Services	<input type="checkbox"/> trash

Add product or service Clear all lines

Customer payment options Edit

Subtotal \$422.00

Discount 0% \$0.00

Activate online card or bank transfer payments for your business

Common Pitfalls and Best Practices

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Dysfunctional Expenses - Common Pitfalls

- Over-allocating to programs without support.
- Inconsistent methodologies year over year.
- Lack of documentation.
- Treating allocations as an afterthought.
- Misalignment with actual activities.
- Confusing indirect costs with program costs.
- Overcomplicating allocations

....

Dysfunctional Expenses - Common Pitfalls

Confusing indirect costs with program costs.

- Certain grants will allow Organization's to charge overhead to the grant to recoup operating costs.
- This does not inherently mean a cost is a program cost. It's important the Organization establish guidelines to identify and track those costs for grant reporting when they may be reported as Management and General for the Statement of Functional Expenses. This is a benefit of using both the class and customer functions in QuickBooks.

.... Avoiding Dysfunction: Best Practices

Documentation

- Maintain detailed records to support allocation methods

Consistency

- Use rational, repeatable methods!

Oversight

- Have independent individuals review (a member of management, supervisors, an outside accountant, etc.)

Policy

- Establish a written policy for allocations (i.e. an internal accounting manual, memo, standard allocation worksheets, etc.).

.... Avoiding Dysfunction: Best Practices

- Expense allocations are a management estimate, and some judgement is required.
- The level of detail needed to allocation expenses will depend on your Organization's needs including grantors' expectations, the needs of your board of trustees, materiality, and available resources. When in doubt, consult your accountant!

.... Conclusion & Key Takeaways

The Statement of Functional Expense is more than a compliance requirement!
It provides:

Accurate tracking and thoughtful allocations are critical

- Assists management and the board in decision making and strategic planning.

Strong policies, consistency, and transparency build trust

- Provides key information to current and prospective grantors and donors.

Continuous improvement opportunities

Questions





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