

## SECTION 4470

### disclosure of allocated expenses by not-for-profit organizations

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#### PURPOSE AND SCOPE

- .01 This Section establishes disclosure standards for a not-for-profit organization that classifies its expenses by function (see FINANCIAL STATEMENT PRESENTATION BY NOT-FOR-PROFIT ORGANIZATIONS, paragraph 4400.31) and allocates its expenses to a number of functions to which the expenses relate.
- .02 This Section does not require organizations to classify their expenses by function or to undertake any allocations.

#### ATTRIBUTION AND ALLOCATION OF EXPENSES

- .03 Reporting expenses by function frequently requires an organization to attribute individual expenses among the functions to which they relate. Some expenses contribute to, or produce the output of, more than one function and are considered directly related to the output of each of those functions, for example, the remuneration of a staff person who works in more than one separately reported function. An organization also incurs expenses of a general support nature that, although necessary to perform its other functions, do not directly contribute to, or produce the output of, such functions.
- .04 When all of the expenses of a function have been accumulated within that function, an organization may wish to allocate some expenses from that function to another function when there is a clear relationship between those expenses and the other function. A common example is the allocation of certain specific fundraising and general support expenses to other functions to which they relate. As aggregate amounts reported for the fundraising and general support functions are often of particular significance to financial statement users, allocations involving these two functions are addressed by this Section.
- .05 Occasionally, fundraising expenses include amounts which are specifically directed at another function (for example, education). In determining whether any expenses included in the fundraising function might be allocated to another function, there must be a reasonable basis for making such an allocation, applied on a consistent basis.
- .06 General support expenses are incurred to support the variety of functions undertaken by the organization, including revenue generating functions, if any, such as fundraising. General support expenses include expenses of the administration or general office activities (for example, corporate governance, general management, payroll administration, budgeting and accounting, information technology, human resources, and financing).
- .07 General support expenses are either considered a function in their own right or are allocated on a reasonable and consistent basis to the relevant functions that they support.

#### DISCLOSURE OF ALLOCATED EXPENSES

- .08 *When allocations of fundraising and general support expenses have been made to other functions, the accounting policy disclosure should explain the policies adopted for the allocation of expenses among functions, the nature of the expenses being allocated and the basis on which such allocations have been made. In addition, the amounts allocated from each of these two functions, and the amounts and the functions to which they have been allocated, should be disclosed.*
- .09 The results of operations of each function are important to users. However, additional scrutiny is often applied to the total cost of fundraising and the total cost of general support of not-for-profit organizations that receive funds from the public. Disclosure of allocations that have been made in the case of fundraising and general support expenses, including amounts, enhances a reader's ability to understand the effect of the allocations, and thus improves the ability to conduct comparisons among organizations' financial statements.

#### EFFECTIVE DATE

- .10 This Section applies to annual financial statements relating to fiscal years beginning on or after January 1, 2012. Earlier application is permitted.

## **APPENDIX**

### **APPLICATION GUIDANCE**

This Application Guidance is an integral part of this Section and is applicable to an organization that chooses to classify its expenses by function.

#### **Attribution of expenses**

- A1 When attributing an expense among various operating functions, an organization considers an approach such as the following:
- (a) An expense that contributes directly to the output of one function is applied directly to that function, for example, the cost of a staff member exclusively devoted to that function.
  - (b) An expense that contributes directly to the output of more than one function is attributed on a reasonable and consistent basis to each function to which it applies (for example, the rent applicable to the space used for more than one separately reported function, and the remuneration expense of an executive director of a small health care organization who, in addition to managing the organization, provides direct health care services to clients of that organization).

#### **Bases for attribution**

- A2 The bases adopted for attribution are appropriate to the category of expense concerned and to the organization's particular circumstances.
- A3 There are a number of bases for attributing expenses that may be applied. Examples include:
- (a) time — on the basis of hours incurred directly in undertaking a function;
  - (b) usage — on the basis of measured or estimated consumption attributable to the function;
  - (c) per capita — on the basis of the number of people employed within a function; and
  - (d) space — on the basis of floor area occupied by a function.

#### **Allocation of expenses**

- A4 Once accumulated by function, expenses may only be allocated to another function when there is a clear relationship between those expenses and the other function. For example, information about the organization's objectives and projects is often provided in the context of its fundraising activities. In determining whether some of those fundraising expenses might be allocated to an education function, a distinction needs to be drawn between:
- (a) information involved in raising the profile of the organization which is associated with fundraising (expenses of generating funds); and
  - (b) information that is provided by the fundraising activities in furtherance of the organization's objectives, such as education (expenses of delivering services).
- A5 In the context of a fundraising activity, for information to be regarded as, for example, also contributing to an education objective, it is supplied in an educational manner. To achieve an educational purpose, information supplied meets the following three criteria. The information is:
- (a) targeted at individuals or others who can use the information in furtherance of the organization's objectives;
  - (b) advice on which the recipient can act in an informed manner in furtherance of the organization's objectives; and
  - (c) related to the educational activities or objectives undertaken by the organization.
- If the information provided in conjunction with the fundraising activity does not meet these criteria, it would be regarded as targeted at potential donors and therefore relating wholly to the fundraising activity.
- A6 For example, a health education organization targets high-risk groups of people or the medical profession by supplying information as to health risks or symptom recognition and advising on steps to be taken. Such information falls within service delivery expenses as it is targeted at specific recipients, advises on specific steps that can be taken, and is directly related to the organization's specified activities or objectives in health education. Therefore, when such information is provided in the context of a fundraising activity to those target populations, expenses may be allocated between the fundraising and service delivery activities.
- A7 In the example in the previous paragraph, if it were determined that the information supplied is either only of marginal value to the target population or its value to the target population cannot be determined with any reasonable certainty, the educational component would not be satisfied and the expenses would be treated entirely as fundraising expenses.
- A8 The expenses related to fundraising activities targeted at prior donors, or at individuals or corporations otherwise selected based on their ability or likelihood to donate to the organization, are presumed to relate solely to fundraising. In determining whether this presumption may be overcome, an organization considers the extent to which the targeted individual or corporation is selected based on its ability or likelihood to donate to the organization and contrasts that with the extent to which it is selected for one or more of the reasons in paragraph A5. For example, if the target's likelihood to donate is a significant factor in its selection and it has a need for the educational component described in paragraph A5, but having that need is an insignificant factor in its selection, the presumption would not be overcome.

#### **Changes in bases for allocation of expenses**

- A9 The bases adopted for allocation of expenses are accounting policies to which ACCOUNTING CHANGES, Section 1506 in Part II of the Handbook, applies when a change is made.

### ILLUSTRATIVE EXAMPLES

This material is illustrative only.

These examples illustrate how the accounting treatment specified in this Section might be applied in particular situations. Matters of principle relating to particular situations should be decided in the context of this Section.

#### Cost allocation when an organization chooses to report by function

|                                | Function 1<br>(Patient care) | Function 2<br>(Education) | Function 3<br>(Fundraising) | Function 4<br>(General support) |
|--------------------------------|------------------------------|---------------------------|-----------------------------|---------------------------------|
| <b>Attribution of expenses</b> |                              |                           |                             |                                 |
| Expense A                      | 100%                         |                           |                             |                                 |
| Expense B                      |                              | 100%                      |                             |                                 |
| Expense C (a)                  | 50%                          | 25%                       | 15%                         | 10%                             |

- (a) For purposes of this illustration, Expense C is an expense that contributes directly to the output of several functions. In accordance with this Section, no additional disclosure is required with respect to the attribution of this expense among the various functions to which it relates.

|   | Function 1<br>(Patient care) | Function 2<br>(Education) | Function 3<br>(Fundraising) | Function 4<br>(General support) |
|---|------------------------------|---------------------------|-----------------------------|---------------------------------|
| <b>Allocation from one function to another</b>        |                              |                           |                             |                                 |
| Fundraising expenses, if allocated                    |                              | 10%                       | 90%                         |                                 |
| — Disclosure of policy and dollar amounts is required |                              |                           |                             |                                 |
| General support expenses are either:                  |                              |                           |                             |                                 |
| • Not allocated                                       |                              |                           |                             | 100%                            |
| — No disclosure                                       |                              |                           |                             |                                 |
| • Allocated   | 30%                          | 25%                       | 15%                         | 30%                             |
| — Disclosure of policy and dollar amounts is required |                              |                           |                             |                                 |

#### Disclosure of allocated expenses by a not-for-profit organization

This example assumes that the organization has chosen to report its operations by function.

##### Note A: Accounting policy — allocation of expenses

NFP A engages in patient care, education and fundraising programs. The costs of each program include the costs of personnel, premises and other expenses that are directly related to providing the program. NFP A also incurs a number of general support expenses that are common to the administration of the organization and each of its programs.

Both the education and fundraising programs include the use of the same brochures to further the work of NFP A. The brochures are designed and intended to achieve a specific educational objective. The cost of the brochures used directly by the education and the fundraising program is included in each program. Some of the brochures included in direct mail fundraising campaigns are mailed to individuals who have been identified as potential beneficiaries of the educational component of the brochures. The cost of those specific brochures has been allocated from the fundraising to the education program. The majority of the direct mail campaign expenses remain a cost of the fundraising program.

NFP A allocates certain of its general support expenses by identifying the appropriate basis of allocating each component expense, and applies that basis consistently each year. Corporate governance and general management expenses are not allocated; other general support expenses are allocated on the following bases:

Human resources department costs — proportionately on the same percentage as the direct salaries and benefits of the program

Information technology department costs — proportionately on the basis of the total costs of the program excluding IT department costs

##### Note X: Allocation of expenses

##### Fundraising expenses

Fundraising expenses reported in the statement of operations of \$77,000 (20X1 — \$72,000) are reported after allocation of \$6,000 (20X1 — \$5,200) to the education program representing the cost of brochures that were part of the direct mail campaign and were sent to specific individuals who can benefit from the educational content therein.

*General support expenses*

Human resources and information technology department expenses of \$99,000 (20X0 — \$92,000) have been allocated as follows:

|                | <u>20X1</u>   | <u>20X0</u>   |
|----------------|---------------|---------------|
| Patient care   | \$29,000      | \$27,000      |
| Education      | 25,000        | 23,000        |
| Fundraising    | 15,000        | 14,000        |
| Administration | <u>30,000</u> | <u>28,000</u> |
| Total          | \$99,000      | \$92,000      |
|                | =====         | =====         |

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