

Implementing Functional Accounting Using the Unified Chart of Accounts

Wouldn't you like to know what it really costs to run your programs so you would know how much to request of a new (or old) funding source?

Academy Charities 2003 100 Research Program Report July 2003 through June 2004		Accrual Basis		
	Health & Human Services	unrestricted	TOTAL	
Ordinary Income/Expense				
Income				
6900 · Assets released fr restriction				
6910 · Satisfaction of program restric	\$ 92,025.40	\$ -	\$ 92,025.40	
Total 6900 · Assets released fr restriction	<u>92,025.40</u>	<u>-</u>	<u>92,025.40</u>	
Total Income	92,025.40	-	92,025.40	
Expense				
7000 · Grant & contract expense				
7040 · Awards & grants - individuals	5,000.00	-	5,000.00	
Total 7000 · Grant & contract expense	<u>5,000.00</u>	<u>-</u>	<u>5,000.00</u>	
7200 · Salaries & related expenses				
7220 · Salaries & wages	40,468.93	8,748.21	49,217.14	
7230 · Pension expense	1,394.04	286.56	1,680.60	
7240 · Other benefits	7,881.83	1,282.58	9,164.41	
7250 · Payroll taxes	3,787.16	778.49	4,565.65	
Total 7200 · Salaries & related expenses	<u>53,531.96</u>	<u>11,095.84</u>	<u>64,627.80</u>	
8100 · Nonpersonnel expenses				
8130 · Telephone & telecomm	273.03	43.42	316.45	
Total 8100 · Nonpersonnel expenses	<u>273.03</u>	<u>43.42</u>	<u>316.45</u>	
8200 · Facility & equipment expenses				
8210 · Rent & parking	7,379.06	1,475.40	8,854.46	
8260 · Equip rental & maintenance	1,178.75	245.90	1,424.65	
8270 · Depr & amort - allowable	825.14	172.14	997.28	
8280 · Depr & amort - not allowable	-	4,166.60	4,166.60	
Total 8200 · Facility & equipment expenses	<u>9,382.95</u>	<u>6,060.04</u>	<u>15,442.99</u>	
8500 · Other expenses				
8520 · Insurance	471.50	98.36	569.86	
Total 8500 · Other expenses	<u>471.50</u>	<u>98.36</u>	<u>569.86</u>	
Total Expense	<u>68,659.44</u>	<u>17,297.66</u>	<u>85,957.10</u>	
Net Ordinary Income	23,365.96	(17,297.66)	6,068.30	
Other Expense				
9830 · Capital purchases - equipment	15,000.00	-	15,000.00	
9930 · Program admin (10% of direct)	8,365.96	1,729.76	10,095.72	
Total Other Expense	<u>23,365.96</u>	<u>1,729.76</u>	<u>25,095.72</u>	
Net Income	<u>\$ -</u>	<u>\$ (19,027.42)</u>	<u>\$ (19,027.42)</u>	

This is money that needs to be raised!

How about reports to show how much you are spending on your various programs and where you get your funding?

Academy Charities 2003
Total Expenses by Program
 July 2003 through June 2004

Accrual Basis

	<u>Jul '03 - Jun 04</u>	<u>% of Column</u>
100 Research	96,052.82	19.12%
200 ED		
211 Student Ed	187,367.12	37.31%
221 Teacher Ed	100,771.39	20.06%
Total 200 ED	288,138.51	57.37%
500 M&G		
510 Management	76,922.59	15.32%
520 Governance	8,416.09	1.68%
530 Membership development	6,163.17	1.23%
Total 500 M&G	91,501.85	18.22%
600 S/E		
611 Annual Dinner	11,909.42	2.37%
621 Promotion - Annual Dinner	1,727.41	0.34%
Total 600 S/E	13,636.83	2.72%
700 Fundraising	12,932.03	2.58%
TOTAL	502,262.04	100.0%

Over half of the expenses are for this program.

Academy Charities 2003
Income Report
 July 2003 through June 2004

Accrual Basis

	<u>Jul '03 - Jun 04</u>	<u>% of Income</u>
Ordinary Income/Expense		
Income		
4 - Contributed Income		
4010 - Individual contribution	\$ 34,550	2.81%
4110 - GAAP in-kind services	6,200	0.5%
4120 - Non-GAAP in-kind services	5,000	0.41%
4140 - Gifts in kind	15,000	1.22%
4210 - Corporate grants & sponsorships	40,000	3.25%
4230 - Foundation & trust grants	62,000	5.03%
4520 - Federal grants	775,000	62.92%
4540 - Local government grants	150,000	12.18%
Total 4 - Contributed Income	1,087,750	88.31%
5 - Earned Revenue		
5180 - Program service fees	25,500	2.07%
5210 - Membership Dues	83,641	6.79%
5310 - Interest on savings	1,090	0.09%
5320 - Dividends & interest-securities	2,625	0.21%
5440 - Gross sales - inventory	1,145	0.09%
5490 - Other revenue	4	0.0%
Total 5 - Earned Revenue	114,004	9.26%
5800 - Special Events		
5810 - Special events revenue(nongift)	4,500	0.37%
5820 - Special events contributions	25,500	2.07%
Total 5800 - Special Events	30,000	2.44%
Total Income	\$ 1,231,754	100.0%

Over 80% of the funding is from contributions.

Wouldn't it be nice if your accounting records mirrored the Form 990 and GAAP requirements for reporting?

Academy Charities 2003	
Income Tax Summary	
As of June 30, 2004	Accrual Basis Jun 30, 04
Pt I-Contribs	
Direct public support	136,550.00
Government contribs	925,000.00
Noncash contribs	15,000.00
Pt VII-Income	
(e)-Program service rev.	25,500.00
(e)-Membership dues	83,640.83
(d)-Interest-savings	1,089.50
(d)-Div/int-securities	2,625.00
(e)-Other revenue	3.70
Pt I-Other Rev	
Gross receipts-special events	4,500.00
Contributions-special events	(25,500.00)
Gross sales of inventory	1,145.00
Pt II-Col(B)-Program Svcs	
Grants/allocations-cash	5,000.00
Officers' compensation	63,331.61
Other salaries/wages	147,723.49
Pension plan contributions	7,200.00
Other employee benefits	39,299.00
Payroll taxes	19,560.01
Supplies	43,256.00
Telephone	1,199.00
Postage and shipping	526.82
Equip rent/maintenance	17,656.81
Printing and publications	42,782.00
Travel	1,038.00
Conference/conventions/mtgs	3,500.00
Other expenses	21,045.00
Pt II-Col(C)-Mgmt/Gen	
Accounting fees	6,120.00
Occupancy	37,400.00
Interest	2.30
Depreciation	26,422.00
Pt II-Col(D)-Fundraising	
Prof fundraising fees	5,000.00

You can get these reports (and more!) by using the implementing functional accounting with the Unified Chart of Accounts.

FUNCTIONAL ACCOUNTING

Functional accounting is an approach to recording your financial activity that has many similarities to traditional cost or managerial accounting. While there is no official requirement that we take this approach, it provides an ideal method for both tracking the real costs of program and supporting activities – a valuable tool for management decision-making – and for meeting external reporting requirements.

Many organizations are required to provide audited financial statements to their lenders, funding sources, and boards and private or government funders prepared in accordance with Generally Accepted Accounting Principles (GAAP). GAAP requires a breakdown of expenses by major program function. The IRS Form 990 also requires that you identify how money is spent by the broad functions of Program, Management, and Fundraising (Part II) and that you break out the Program expenditures into four main accomplishments (Part III). GAAP financial statements (audits) require this same breakdown of expenditures plus a Statement of Functional Expenses that elaborates on the activities of these three functions.

The Form 990 is public information and is available for all public charities on the GuideStar website (www.guidestar.org). Watchdog groups, the press, and grant-makers examine these numbers and make judgments about the efficiency and worthiness of individual organizations and the sector as a whole. Funding sources often want to know how much the entire program costs, not just their portion of it.

To meet these reporting needs, the well-managed organization first identifies all the direct costs associated with each major activity and fairly allocates all common (indirect) costs associated with maintaining the activities. Only after all the costs of the program are known does the organization determine which funding source(s) can and will pay those costs.

Some organizations have come to think of their grants as programs, both in their accounting system and in their “self-talk.” Instead of talking about their (say, job training) program, they refer to it as the Big Bucks [Foundation] program. This is misleading and self-limiting. For starters, the only costs that will be charged to the Big Bucks program are those that will be paid by the funder. There is no place to put any costs of the job training program that won’t be paid by the funder, so those costs usually end up in Management. So what, you

say? Two bad things happen with this – Management costs are overstated and you don't know how much it actually costs to run the program. If you don't know the real costs of a program, you may continue a non-viable program past its reasonable end. You also don't know how much to ask another funding source to provide to continue the program.

The key here is that you need to know what it really costs to accomplish your mission and who is helping pay those costs. With the true financial picture in hand, you have a much better case for asking for additional or new funding, and for making wise management decisions.

HISTORY OF THE UNIFIED CHART OF ACCOUNTS (UCOA)

The UCOA was years in the making, and continues to be developed. The concept and design of a standard chart of accounts for nonprofits actually dates back to 1974 when Russy Sumariwalla developed his "Illustrative Chart of Accounts, UWA Accounts Coding System (UWAACS)." "I-COA" was published in *the United Way of America Accounting and Financial Reporting Guide*, first in the 1974 edition and updated in the 1987 edition.

In 1994, Bill Levis simply made a copy of the 1987 "Illustrative Chart of Accounts" and annotated it with the corresponding Form 990 line items and called it the "Model Chart of Accounts." In 1998, the State of Tennessee published their *Accounting and Financial Reporting for Not-for-profit Recipients of Grant Funds in Tennessee* guide with an adaptation of the Model COA titled "Universal COA." The cross-reference to OMB Circular A-122 was added at that time. In 2000, the California Association of Nonprofits' Quality Reporting Project Task Force vetted the Universal COA. This was included in *Unified Financial Reporting System* by Russy and Bill, published by Jossey-Bass, as the "Unified COA."

Like Part II of Form 990, UCOA consists, in part, of generic "natural" accounts that can be used by any organization and program. In addition to the Form 990 accounts, it has accounts needed for GAAP (audited) financial statements and for A-133 Single Audit reports. As Bill Levis continues his work with more state and federal agencies, UCOA is being expanded to include accounts needed for federal and state grant reports. We are especially excited to be working with the federal government and the National Association of State Auditors, Comptrollers, and Treasurers (NASACT) on their grants streamlining

project that will result in more standard requirements across state and federal agencies and in an electronic means of applying for and reporting on federal grants and contracts.

We are still working on this Chart. As the federal and state governments create their on-line reporting and revise their paper reporting, UCOA will be modified to make this reporting more efficient. UCOA is a living document and we welcome, make that **request**, your thoughts on improving it.

THE PURPOSE OF UCOA

The "U" in UCOA stands for Unified – the unification of all your financial reporting needs into one set of accounting records. By using a generic chart of accounts and a well-thought-out chart of activities, you should be able to produce meaningful reports for everyone who needs them with the least amount of effort.

UCOA is a framework for functional accounting of your organization's finances. It can help to simplify and organize your approach to financial record-keeping, while providing more and better information for management, the board, the IRS, and your funding sources. UCOA can be used with any accounting system and by any size organization.

UCOA and Functional Accounting can increase the efficiency and accuracy not only of your accounting department, but of the organization as a whole. Many program managers (and sometimes Executive Directors!) in many organizations keep what we call parallel sets of books. They are not getting what they need from their accounting departments and feel compelled to do their own tracking of grant and program expenses. This is not good use of a program manager's time and energy and is prone to lots of human error. The accounting department should be able to provide this information.

With a well-planned accounting structure and good internal processes, you will be able to provide grant, program, budget, Board, auditor, fundraising, and other management reports quickly, accurately, and consistently. Reports prepared for one audience, say the IRS, will agree with those prepared for others such as the Board. The system will be unified.

THE STRUCTURE OF UCOA

1. The first part of UCOA is the lines or rows, those generic natural account names that any organization could use. These include the Balance Sheet accounts – assets (cash, equipment, receivables), liabilities (payables, deferred income, loans), and equity (known to not-for-profit organizations as net assets) – as well as the Income Statement accounts – income (contributions, dues, grants) and expense (salaries, postage, travel). The really important thing about these accounts is that they are generic and make no reference to what program or funding source any activity relates.
2. The second part of UCOA is the activity part, those columns for tracking activities. In addition to providing functional information required by Form 990 and GAAP statements, functional costing provides invaluable program and management information. Whether or not program expenses are paid by a grant, you need to know the true costs of carrying out your mission. Using functional accounting, an organization can meet its reporting obligations and obtain useful operational information with one set of accounting records, saving time and increasing accuracy by entering financial data only one time.
3. Then there is the third dimension, your funding sources. Many accounting software packages (QuickBooks, for sure) will allow you to track all revenues and expenses associated with particular sources of revenues (grants).

There are five broad categories of accounts, each with its sub-categories:

Balance Sheet Accounts

1. Assets
 - a. *Current assets* – cash and cash equivalents; short-term investments; accounts receivable; inventory; prepaid expenses
 - b. *Fixed assets* – furniture; equipment; building; leasehold improvements; accumulated depreciation
 - c. *Noncurrent assets* – long-term investments; capitalized collections; long-term accounts receivable; land and other natural resources; long-term prepaid expenses and deposits; split-interest assets; security deposits
2. Liabilities

- a. *Current liabilities* – accounts payable and accrued expenses; deferred revenue; refundable advances; current portion of long-term obligations
 - b. *Noncurrent liabilities* – long-term obligations; government-owned fixed assets; split-interest liabilities
3. Net Assets or Equity
- a. unrestricted net assets
 - b. temporarily restricted net assets
 - c. permanently restricted net assets

Income Statement Accounts

4. Revenues
- a. Contributed revenues – direct contributions; donated goods and services; government and other grants; split-interest agreement revenues; United Way and other indirect contributions
 - b. Earned revenues – government contracts; program sales and fees; dues; investment revenues; other revenues
 - c. Special event revenues
 - i. non-gift portion
 - ii. gift portion
5. Expenses
- a. Grants, contracts, and direct assistance
 - b. Salaries and related expenses – salaries; pension contributions; employee benefits; payroll taxes
 - c. Contract service expenses - fundraising fees; accounting fees; legal fees; professional fees; donated services
 - d. Non-personnel expenses – supplies; telephone; postage; printing
 - e. Facility and equipment expenses – rent , parking, and utilities; equipment rent and maintenance; depreciation; donated use of facilities
 - f. Travel and meetings expenses
 - g. Other expenses – interest; insurance; advertising; taxes
 - h. Non-GAAP expenses - capital purchases; payments to affiliates; additions to reserves; program administration (indirect) expenses

Activities/ Functions/Programs/Purposes. Form 990 refers to functions in Part II Statement of Functional Expenses where you are required to show expenses by the three functions of Program, Management, and Fundraising. In audited (prepared according to GAAP) financial statements, there is also a Statement of Functional Expenses. This statement has two main headings – Program Services and Supporting Services – with further breakdowns.

Supporting Services are broken down into Management, Membership Development, and Fundraising while Program Services are broken down in whatever way best presents the activities of the organization. The fact that the Statement of Functional Expenses provides detail for the Statement of Activities and that both use the same program descriptions indicates that even GAAP thinks that the terms "Activity" and "Function" are interchangeable. Other words that are used to mean the same thing are Programs, Purposes, Cost Centers, and Service Efforts. In QuickBooks they are called Class and Sub-Class.

1. **Program services** are the activities that relate to your mission and that result in the delivery of goods or services to your beneficiaries. The more mission-related activities your organization has the more columns and sub-columns you will have in the *Program Services* sections of your Statements of Activities and of Functional Expenses. UCOA suggests identifying the four major functions of the organization (corresponding to Part III of Form 990 and the GAAP Statement of Functional Expenses), with specific activities of each function as sub-functions. An example would be an organization with major program functions of Education and Research. Within the Education function, it could have age-group activities (pre-school, primary, and secondary), subject activities (science, humanities, and engineering), or location activities (downtown, uptown, and suburban). Our sample organization has two activities within the education function – student and teacher education.

If your organization does any lobbying, you will need to track the two kinds of lobbying – direct lobbying and grass-roots lobbying.

2. **Supporting services** are those activities of your organization that are not program services. Indispensable as they are to the existence of an organization that is able to deliver mission-related program services, they are not directly related to those program services. There are three major categories of supporting services – management & general/governance (M&G), membership development, and fundraising.
 - a. *Management & general/governance* services are those that relate to the overall direction of the organization. They include such activities as:
 - i. Office management

- ii. Human resource management
- iii. Annual report preparation
- iv. Legal services
- v. Auditing and accounting services
- vi. Board and committee meetings
- vii. Material acquisition and distribution
- viii. Organizational planning
- ix. Exchange transaction solicitation
- x. Reception, mailroom, & switchboard

If you have government grants, you will need to track certain other supporting service activities (if you have them) as *Unallowable M&G* because OMB Circular A-122 defines them as unallowable for both reimbursement and in calculating your indirect rate. Of particular interest are:

- i. Investment management,
- ii. Labor relations,
- iii. Public relations, and
- iv. Other unallowable M&G.

- b. *Membership Development* activities relate to the solicitation and retention of members. This includes activities such as member database maintenance, dues collection, and other member relation activity. Members are those who receive some significant benefit or acquire duties as a result of their membership. If there are no significant benefits or duties related to membership, then the activities are actually fundraising. For example, the \$30 contribution you might make to become a "member" of your local public radio station is, for most accounting and IRS purposes, treated as a contribution, not as membership dues, and any associated costs are treated as fundraising expenses.
- c. *Fundraising* activities are those related to the solicitation of contributions, grants, and services.

A special kind of fundraising is a special event which has two components to track – production of the event and promotion of the event. The costs of production are also referred to as the cost of direct benefits to the donors (such as the cost of a dinner). These are costs of an exchange transaction (M&G) not fundraising costs, and are

netted against the exchange portion of the revenue in Part I of Form 990 (line 9). The costs of conducting and promoting the event are fundraising costs and are reported in the Fundraising column of Part II of Form 990; with the revenues reported in Part I (line 1a).

3. **Cost Pools.** As a practical matter, some costs need to be pooled together before they are assigned or allocated to your organization's activities. The most common cost pools are:
- a. Salaries and related expenses
 - b. Facilities expenses
 - c. Central service centers like the IT department

These "activities" are used to collect expenses during the period (usually month), then are emptied by dispersing them line by line at the end of the period to the programs. The allocations are done on some reasonable basis - timesheets for salaries - and result in a zero balance in the cost pool.

Notice that we have yet to mention funding sources or grants. Each of these three pieces of information - account, activity, and funding source - is a discrete and separate data point. There is no duplication of information among them. Your accounting software needs to have the ability to track and report on various combinations of these data.

◆ 100 Research
◆ 200 ED
◆ 211 Student Ed
◆ 221 Teacher Ed
◆ 299 Education program admin
◆ 300 Conference
◆ 500 M&G
◆ 510 Management
◆ 520 Governance
◆ 530 Membership development
◆ 600 S/E
◆ 611 Annual Dinner
◆ 621 Promotion - Annual Dinner
◆ 700 Fundraising
◆ 911 Occupancy Cost Pool
◆ 921 Salaries Cost Pool
◆ 998 Time Restricted Funds
◆ 999 Perm Restricted Funds

Activity List for Academy Charities

Funding sources. Your funding can come in three different forms:

1. Unrestricted contributions and earned revenues
 - a. Designated for purpose
 - b. Designated for quasi-endowment
 - c. Undesignated
2. Temporarily Restricted contributions and grants
 - a. Restricted to a special purpose
 - b. Restricted to a certain period of time
3. Permanently Restricted contributions
 - a. Earnings are temporarily restricted
 - b. Earnings are not restricted

Only funding that is donated from outside the organization is considered legally restricted. It is a common mistake to refer to activities as being restricted, usually because of thinking of grants as activities. Many programs are funded by a combination of restricted and unrestricted grants and gifts, and earned revenues. Regardless of source or level of restriction, funding and revenues are the means to accomplish your mission ends. Funding is not an end in itself.

Temporarily Restricted funds are contributions that are restricted by the donor to either purpose or time. Purpose restrictions are met by spending the funds on the program or activity specified by the donor. Time restrictions are met by the passage of time. In either case, once the restrictions have been met, the funds are released to Unrestricted funds.

Permanently Restricted funds are contributions that the donor has stated must be kept in perpetuity. Earnings from the funds may be temporarily restricted to purpose or time, or they may be unrestricted. In addition to donor specification of permanent restriction, the fund may be increased with funds that were temporarily restricted but the organization was unable to meet the restriction. If the organization cannot meet the purpose or time restriction of a gift and it is not possible to return the gift, then it turns into a permanently restricted gift.

Some *Unrestricted* funds may be designated by the Board for specific use. These are similar to Temporarily Restricted funds, but are considered Unrestricted because the Board can change its mind on the designation.

The matters of identifying funding sources and of tracking the receipt and release of restricted and designated funds lead to some interesting bookkeeping challenges. Some high-end not-for-profit accounting

software packages are set up to track restrictions on funding. Off-the-shelf accounting software such as QuickBooks and Peachtree will have to be manipulated into doing this tracking.

The illustrations in this Guide are from a QuickBooks ® file. QuickBooks ® is the most widely used accounting software package for small and medium sized not-for-profit organizations, and is relatively easily adapted to their needs.

In any case, expenses that are paid by a grant for a particular purpose or period of time have to be associated with that grant. In addition to coding an expense with an account and an activity, you will need to specify the funding source. With activities that are funded by several funding sources, the decision of which grant to charge with what expenses often occurs at the end of the month. The program or grant manager looks at all the costs for that activity for the month and distributes them according to the terms of the grants, funds left to spend in the grants, and other factors. It is important to remember that expenses are assigned to the activity first and the funding source second.

There are often costs of an activity that are not paid by the grants. Depending on the software, you may need to identify these expense with a funding source called "unrestricted." Without this information, the organization will not know the full costs of carrying out the activity.

INSTALLING THE UNIFIED CHART OF ACCOUNTS

1. Accounts

You can either adopt the UCOA in its entirety, or you can use it to evaluate and improve your existing chart of accounts. Either way, you need to start with a copy of your current chart of accounts and a copy of UCOA. As you work your way down the charts, write the corresponding account number(s) on the other chart.

For example, let's assume that on your chart you have three accounts for supplies:

- a. 7566 Office supplies
- b. 8614 Computer supplies
- c. 9687 Program supplies

Write the number 8110 (Supplies from UCOA) next to each of these supplies accounts on your current chart. Write the numbers 7566, 8614, and 9687 next to 8110 Supplies on the UCOA list. Do this until you have cross-referenced as many accounts as you can. Some problems may begin to surface.

- a. UCOA has two or more accounts where your chart has one. An example of this would be if your chart had one account for Legal and Accounting Expenses. UCOA has two separate lines--7520 Accounting fees and 7530 Legal fees--because Form 990 has two lines, 31 Accounting fees and 32 Legal fees. To provide the information needed for Form 990, you will need to separate your one account into two.
- b. UCOA has one account and your chart has two or more. For instance, your organization may need to track several kinds of professional services, making the one UCOA account, 7540 Professional fees, inadequate. The next UCOA number is 7550, so there is plenty of room for you to break down your professional fees into sub-accounts such as 7541 Artistic fees and 7542 Technical fees.
- c. **UCOA has nothing at all like your account.** This usually occurs when you have an account line that is actually an activity. A board of directors' expense account won't translate to UCOA (or Form 990) because the expenses charged to it belong in several UCOA accounts – printing, salaries, telephone, supplies, etc. This is a signal that you need to restructure your chart of activities. You will have to decide whether to add a new activity or integrate this activity into an existing one.

If your existing chart of accounts is in relatively good shape, you can simply modify it with new or renamed/renumbered accounts from UCOA. You do not have to change your account numbers; however, if you find that you need to rearrange a lot of accounts you may want to simply adopt the UCOA numbers. If you use QuickBooks ® and choose to import the chart of accounts from our template, you gain the advantage of having all the accounts already associated with the Form 990 lines.

If your chart is in bad shape, it might be best to start a new file. QuickBooks users can download a template file from the California Association of Nonprofits (CAN) website. It contains the full UCOA,

some memorized reports, and a sample chart of activities. Once you have restored this file, you enter your organization's name and address and rename the file. All of the accounts are inactive, so you will have to activate the ones you need at the moment. The advantages of doing it this way are that you don't have to do the work of setting up all those accounts, and you have the full account list in place when you need to add an account.

In addition to the UCOA chart itself, there are also two content lists. They are actually the same list sorted in two different ways. One list is in the order of the UCOA account numbers. It shows you some of the many alternate and additional names for each UCOA account. The other version of the content list is sorted alphabetically so you can look up an account name to see to which UCOA account it belongs. We are always working to improve the UCOA and its tools. Please let us know of additional account names to add to these content lists.

2. Activities

The last page of the UCOA chart provides a suggested framework for numbering and organizing your activities. The more programs an organization has, the more columns and sub-columns it will have in the program section of its Statement of Functional Expenses. UCOA suggests identifying the four major functions of the organization (corresponds to Part III of Form 990 and GAAP Statement of Functional Expenses) with specific activities as sub-functions. However the activities are structured, they need to reflect the actual accomplishments of the organization, as well as its staffing and physical structures. The accounting structure does not stand on its own – it is a reflection of the organization and it exists to support the furtherance of the mission of the organization.

Surprisingly, the exercise of identifying your organization's activities can be very difficult, especially if the organization has been primarily focused on grants instead of activities. Be prepared to involve the entire staff in developing the chart of activities. You will need everyone's understanding and cooperation because this chart then becomes the basis for your timesheet. Staff salaries are as much a direct cost as supplies and travel. Full costing can be achieved only when all staff salaries have been assigned to the appropriate activities, and common (indirect) costs such as rent and copier rental have been allocated to the activities.

The activity numbers use three digits to distinguish them from the four-digit account numbers. We encourage using numbers because they take up less space and are less ambiguous than various wordings of activity names. They also facilitate keeping the activities in a certain order and making the relationships of sub-activities clear.

100 – 499 Program Services and Activities

- 100 Program or Function A
 - 110 Activity 1
 - 120 Activity 2
 - 199 Program A administration
- 200 Program or Function B
 - 210 Activity 3
 - 220 Activity 4
 - 299 Program B administration
- 300 Program or Function C
 - 310 Activity 5
 - 320 Activity 6
 - 399 Program C administration
- 400 Program or Function D
 - 410 Activity 7
 - 420 Activity 8
 - 459 Program D administration
- 460 Lobbying Program
 - 461 Lobbying
 - 462 Grassroots lobbying

500 – 599 Management & Governance

- 510 Management
- 520 Unallowable Management
- 530 Governance (Board of Directors)
- 550 Membership development

600 – 699 Special Events

- 610 Special event production (exchange portion)
- 620 Special event promotion (fundraising portion)

700 - 799 Fundraising

800 – 899 Cost pools

- 810 Central services expense cost pool
- 820 Salary & related expenses cost pool
- 830 Facilities expenses cost pool

900 – 999 Special Use (for QuickBooks ® users)

- 910 Board-designated funds
- 920 Quasi-endowment (board-designated) funds

- 930 Fixed assets (board-designated) funds
- 950 Use-restricted funds
- 960 Time-restricted funds

- 990 Endowment (permanently restricted) funds

3. Funding Sources

If you are using QuickBooks ®, each funding source is a Customer and each individual grant is a Job under the Customer. Even if a grant funds multiple programs, it is still just one grant. In the end you will have to report on how that grant was spent. With funding source and activity being recorded in separate data fields, you will be able to report on which activities were funded by each grant. It is also useful to have a history of all the grants that a particular funding source has provided; hence the need to have the grants be jobs or some other "sub" under the customer.

TRANSACTION CODING

In general, Balance Sheet accounts (assets, liabilities, and equity) do not need to be associated with the other account number segments of activity and funding source. The Balance Sheet accounts stand on their own and are not related to specific activities or grants. Income Statement accounts (income and expense) should always be associated with both an activity and a funding source, even if the funding source is just "unrestricted."

ALLOCATIONS OF COMMON COSTS

According to OMB Circular A-122:

Indirect costs are those that have been incurred for common or joint objectives and cannot be readily identified with a particular final cost objective..... After direct costs have been determined and assigned directly to awards or other work as appropriate, indirect costs are those remaining to be allocated to benefiting cost objectives.

Common Costs are those that benefit more than one activity. There are Common Costs that benefit the entire organization, such as office rent, and there are Common Costs that benefit a particular program, such as program facility rent. In our example, Academy Charities has

an Education Program with two activities of Student Education and Teacher Education. There will likely be costs of managing the Education program. These can be tracked in an additional activity called Education Program Administration.

In addition to true Common Costs, there are certain costs that are just too difficult to assign to the activities that benefit from them. Salaries and related benefits and taxes are the most notable example. These are direct costs to each program and activity; however, they are most easily handled by pooling them and "allocating" them at the end of the month. We use the same word – allocate – to describe both the assignment of salaries, taxes, and benefits and the allocation of common costs.

To top off the allocation confusion, there are also Management costs that can be allocated as Indirect Costs. There are several methods of determining Indirect Costs for government grants (see OMB Cir. A-122). The simplest method is to use the M&G function as the indirect cost pool. All direct costs are assigned, all salaries and related costs are "allocated as if direct," and all common costs are allocated to the individual activities (including Management). Then, for management and grant purposes only, all of the Management costs are allocated to the other activities in one account as Indirect Costs.

All of these allocations are done at the end of the period, ideally monthly, using some fair and consistent procedure. There are no hard and fast rules about how you must calculate these allocations. OMB Circular A-122 simply states that common costs "are allocated individually to benefiting functions by means of a base which best measures the relative degree of benefit." In the Washington, DC area auditors commonly refer to the "Washington Post test" as a means of evaluating an allocation procedure. If you are willing to see your methods described in detail on the front page of the Post for the entire world (and your mama) to see, then it is probably a fair method.

Different types of common costs suggest different allocation bases. Employee salaries, benefits, and taxes should be allocated by the relative amounts of time spent on each of the activities. Facilities costs (rent, office equipment rental, telephone service, etc) could be allocated on square footage in some cases. In others, there is no way to assign square feet to activities because each staff person works on many activities so a better method might be the same time and effort reporting used for salaries. Specific program administration costs might best be allocated on relative direct costs. A Central Service cost

pool such as Client Intake or Information Technology might be allocated based on some non-financial unit of use. Whatever base is chosen should be used consistently and evaluated annually.

In many cases the single base used for all allocations will be time and effort reporting by staff. This requires that each staff member track their time according to the organization's chart of activities. Time should be tracked on actual hours worked for each of the organization's activities, even for exempt employees. The objective is to convert the time worked to percentages of effort which are then applied to the various common costs. The actual allocation is accomplished with a journal entry that debits the individual expense accounts in each of the activities and credits the same expense account in the Cost Pool. When all accounts have been allocated, the Cost Pool has a balance of zero and disappears from the Functional Expense Statement.

You may be tempted to allocate all common costs at once using a special allocation account. That method is good for central service pools and sometimes for facilities costs, but does not meet outside reporting requirements for salaries, benefits, and taxes. The salaries and related costs should be allocated line by line to each of the activities.

With multiple cost pools, the order in which you record the allocations is often important. For instance, your salaries and facilities cost pools may benefit the central service cost pool. You will have to allocate salaries and facilities costs before allocating the central service costs. Program administration cost pools will be allocated after all the organization-wide cost pools have been allocated.

REPORTS

Having recorded and allocated all your expenses, you will be able to produce very useful reports for both internal and external audiences. For Form 990 and GAAP, you will have a Balance Sheet and an Income Statement – known respectively as the Statement of Financial Position and the Statement of Functional Expenses. QuickBooks ® cannot produce a proper Statement of Activities, but all the information is there. The problem with the Statement of Activities is that the Income section is presented by individual account (contributions, program service fees, etc.) while the expenses are presented by activity. It is a hybrid report that QuickBooks ® just can't make yet.

The **Functional Income Statement** is a spreadsheet that shows each of the income and expense accounts as the rows with columns for the activities. This report is usually wide and long, so the columns as well as the rows have been collapsed in this sample.

Academy Charities 2003									
Functional Income Statement									
July 2003 through June 2004									
Accrual Basis	Research	Education	M&G	Annual Dinner	700	996	998	999	
	total	total	total	total	Fundraising	Reserves	Time Restr	Perm Restr	TOTAL
Ordinary Income/Expense									
Income									
4 · Contributed Revenue	0.00	200,000.00	1,200.00	15,000.00	32,050.00	2,500.00	787,000.00	50,000.00	1,087,750.00
5 · Earned Revenue	0.00	26,648.70	87,355.33	0.00	0.00	0.00	0.00	0.00	114,004.03
5800 · Special Events	0.00	0.00	0.00	30,000.00	0.00	0.00	0.00	0.00	30,000.00
6900 · Rev released fr restr	92,025.40	210,486.79	0.00	0.00	0.00	0.00	(302,512.19)	0.00	0.00
Total Income	92,025.40	437,135.49	88,555.33	45,000.00	32,050.00	2,500.00	484,487.81	50,000.00	1,231,754.03
Gross Profit	92,025.40	437,135.49	88,555.33	45,000.00	32,050.00	2,500.00	484,487.81	50,000.00	1,231,754.03
Expense									
7000 · Grant & contract exp	5,000.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	5,000.00
7200 · Salaries & related exp	64,627.80	93,674.43	108,941.29	4,727.16	5,143.43	0.00	0.00	0.00	277,114.11
7500 · Contract services	0.00	35,000.00	7,200.00	0.00	5,000.00	0.00	0.00	0.00	47,200.00
8100 · Nonpersonnel exp	316.45	78,590.03	619.99	1,000.00	237.35	7,000.00	0.00	0.00	87,763.82
8200 · Facility & equip exp	15,442.99	44,886.18	19,464.23	357.60	1,327.81	0.00	0.00	0.00	61,478.81
8300 · Travel & meetings exp	0.00	1,500.00	38.00	3,000.00	0.00	0.00	0.00	0.00	4,538.00
8500 · Other exp	569.86	2,358.30	2,304.54	717.88	66.72	0.00	0.00	0.00	6,017.30
8600 · Business exp	0.00	150.00	0.00	0.00	0.00	0.00	0.00	0.00	150.00
Total Expense	85,957.10	256,158.94	138,568.05	9,802.64	11,775.31	7,000.00	0.00	0.00	509,262.04
Net Ordinary Income	6,068.30	180,976.55	(50,012.72)	35,197.36	20,274.69	(4,500.00)	484,487.81	50,000.00	722,491.99
Other Income/Expense									
Other Income									
6800 · Unrealized gain(loss)	0.00	0.00	(3,500.00)	0.00	0.00	0.00	0.00	0.00	(3,500.00)
Total Other Income	0.00	0.00	(3,500.00)	0.00	0.00	0.00	0.00	0.00	(3,500.00)
Other Expense									
9930 · Indirect (10% of direct)	10,095.72	31,979.57	(47,066.20)	3,834.19	1,156.72	0.00	0.00	0.00	0.00
Total Other Expense	10,095.72	31,979.57	(47,066.20)	3,834.19	1,156.72	0.00	0.00	0.00	0.00
Net Other Income	(10,095.72)	(31,979.57)	43,566.20	(3,834.19)	(1,156.72)	0.00	0.00	0.00	(3,500.00)
Net Income	(4,027.42)	148,996.98	(6,446.52)	31,363.17	19,117.97	(4,500.00)	484,487.81	50,000.00	718,991.99

Academy Charities 2003			
100 Research Program Report			
July 2003 through June 2004			
Accrual Basis	HHS Research		
	Grant	unrestricted	TOTAL
Ordinary Income/Expense			
Income			
6900 · Assets released fr restriction	92,025.40	0.00	92,025.40
Total Income	92,025.40	0.00	92,025.40
Gross Profit			
	92,025.40	0.00	92,025.40
Expense			
7000 · Grant & contract expense	5,000.00	0.00	5,000.00
7200 · Salaries & related expenses	53,531.96	11,095.84	64,627.80
8100 · Nonpersonnel expenses	273.03	43.42	316.45
8200 · Facility & equipment expenses	9,382.95	6,060.04	15,442.99
8500 · Other expenses	471.50	98.36	569.86
Total Expense	68,659.44	17,297.66	85,957.10
Net Ordinary Income	23,365.96	(17,297.66)	6,068.30
Other Income/Expense			
Other Expense			
9800 · Capital purchases	15,000.00	(15,000.00)	0.00
9930 · Program admin (10% of direct)	8,365.96	1,729.76	10,095.72
Total Other Expense	23,365.96	(13,270.24)	10,095.72
Net Other Income	(23,365.96)	13,270.24	(10,095.72)
Net Income	0.00	(4,027.42)	(4,027.42)

REFERENCES

There are many books and articles written on accounting for not-for-profit organizations, as well as the many rules and regulations of the state and federal governments. Listed below are some of the references that contain information on functional reporting

Federal Government rules and regulations.

<http://www.irs.gov> or 1-800-TAX-FORM (829-3676)

The **Internal Revenue Service** has many forms and publications of interest to not-for-profit organizations. In addition to the forms and publications, there are articles on various subjects on the web site. The forms, publications, and articles can be downloaded from the website or ordered over the telephone. You may get some help on the telephone, but it is best if you already know the form or publication number before you call.

<http://www.irs.gov/pub/irs-pdf/i990-ez.pdf>

Instructions for Form 990, Return of Organization Exempt from Income Tax

Specific Instructions for Form 990

Part II Statement of Functional Expenses

Part III Statement of Program Service Accomplishments

<http://www.whitehouse.gov/omb>

The federal **Office of Management and Budget** is charged with, among other things, overseeing federal procurement policies which include the awarding of federal grants and contracts to exempt (not-for-profit) organizations.

<http://www.whitehouse.gov/omb/circulars/a122/a122.html>

Circular A-122 Cost Principles for Nonprofit Organizations

Attachment A General Principles

Part C. Indirect Costs

Part D. Allocation of Indirect Costs and Determination of Indirect Cost Rates

Generally Accepted Accounting Principles.

<http://www.aicpa.org>

The **American Institute of Certified Public Accountants** publishes the *AICPA Audit and Accounting Guide – Not-for-Profit Organizations*. Chances are that your auditor has a copy of this guide in her briefcase. It is the primary reference auditors use to determine whether or not your accounting practices are in accordance with GAAP.

<http://www.fasb.org>

The **Financial Accounting Standards Board** sets the accounting rules that must be followed for audited financial statements.

<http://www.fasb.org/pdf/fas117.pdf>

Statement of Financial Accounting Standards No. 117

Financial Statements of Not-for-Profit Organizations

paragraphs 26 – 28 Information about an Organization's Service Efforts

paragraphs 56 – 64 Statement of Functional Expenses

Non-authoritative, but very useful interpretations, of GAAP.

<http://www.wiley.com>

The publisher John Wiley & Sons, Inc. offers many titles of interest to not-for-profit organizations on all aspects of their existence. There are two titles that are particularly relevant to this discussion.

Wiley Not-for-Profit GAAP 2003: Interpretation and Application of Generally Accepted Accounting Principles for Not-for-Profit Organizations 2003 by Richard F. Larkin, Marie DiTommaso
Chapter 14 Functional Reporting

Not-for-Profit Accounting Made Easy by Warren Ruppel
Chapter 5 Accounting for Activities with Joint Costs and Indirect Cost Allocation

<http://www.ppcnet.com>

The **Practitioners Publishing Company** publishes lots of technical books for accountants, most of which are of no interest to not-for-profit managers. However, there are three books that are of such interest that we advise all our clients to get them. They contain clearly written explanations of why and how to manage every possible financial issue of not-for-profit organizations

PPC's Nonprofit Financial and Accounting Manual
Paragraphs 205.4 – 205.7 Functional Classifications
Paragraphs 707.4 – 707.9 Functional Allocation Methods

PPC's Guide to Nonprofit Expenses
Section 102 Functional Expense Reporting
Section 103 Allocation of Expenses to More than One Function
Section 104 Financial Statement Presentation of Expenses

PPC's Guide to Nonprofit Contributions
Contains nothing on functional reporting or allocations, but is useful for understanding the revenue side of reporting

<http://www.nassembly.org>

The National Health Council and the National Assembly of Health and Human Services Organizations publish what is referred to as the "Black Book."

Standards of Accounting & Financial Reporting For Voluntary Health & Welfare Organizations

You can get a copy of UCOA online from either the California Association of Nonprofits (www.CAnonprofits.org) or the National Center for Charitable Statistics (nccs.urban.org/ucoa/nccs-ucoa.htm). At the CAN site, click on Financial Support and then on Quality Reporting Project. If you want to learn more about the rationale behind UCOA, check out *Unified Financial Reporting System for Not-for-Profit Organizations: A Comprehensive Guide to Unifying GAAP, IRS Form 990 And Other Financial Reports Using a Unified Chart of Accounts* by Russy Sumariwalla and Wilson Levis available from Jossey-Bass at www.josseybass.com

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