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Developing an Operating Budget for Extended Family, Inc.: A Not-for-Profit Human Service Organization

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ABSTRACT: In this case, you will develop an operating budget for Extended Family, Inc., a not-for-profit (NFP) human service organization. Completing this budget successfully requires a high level of decision making, as you must determine the number of cost pools and allocation bases upon which common costs are to be allocated to the organization's three revenue-generating programs. This case will expose you to many real-world issues that NFP financial managers confront when they prepare operating budgets. These issues include: (1) allocating revenue among programs; (2) distinguishing among program, administrative, and fundraising costs; (3) properly treating temporarily restricted contributions; and (4) facing an array of ongoing financial challenges connected with NFPs.

INTRODUCTION

Extended Family, Inc., a community-based, not-for-profit (NFP) organization, was founded in 1995 by a group of parents who were concerned about the stigma surrounding children with disabilities. Specifically, these parents found that such children did not have a place to go to receive specialized counseling aimed at helping them cope with their disabilities. The founding parents also wanted their adult children with disabilities to have an independent, yet supervised, living situation. Originally a grass roots organization with limited support, Extended Family was incorporated in 1999 in order to expand the program from advocating for services to providing services. Extended Family's mission is to educate the community on disabilities and to provide a safe living environment that will enable people with disabilities to live with dignity.

Program Description

Extended Family operates three separate programs: counseling, education, and residential. Clients may be referred to one of these programs by their schools, social service agencies, physicians, or their parents.

Counseling Program

The counseling program provides individual, group, and family counseling sessions. The sessions are individualized and range from coping with a disability to training in activities of daily living, such as using public transportation.

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The authors are very willing to share the sample solution and other data associated with the case.
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Education Program

The education program provides education regarding disabilities to students in the area school systems or teachers and other school personnel, such as cafeteria workers and teacher aides. Additionally, educators participate in community health fairs, hand out information, and answer referral calls at Extended Family.

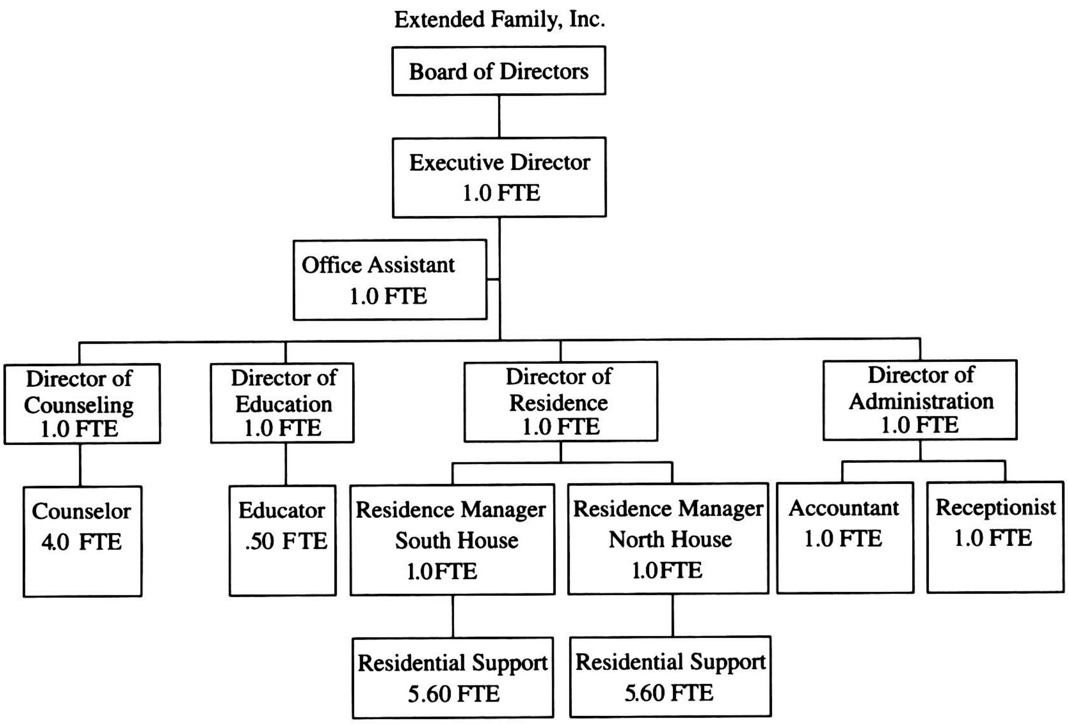
Residential Program

The residential program consists of two group homes with 24-hour care and individual units for residents. In order to qualify for admission, residents must be ambulatory and not require skilled nursing care. The group homes teach the residents life skills, such as grocery shopping, so that they can live independently. Length of stay varies according to an individual's physical capabilities.

Organization Chart

The organization chart of Extended Family, Inc. is presented in Figure 1. It displays the following paid positions that are described below.

FIGURE 1
Organization Chart



Current Year Staffing

Position Descriptions

Executive Director: Reports to the Board of Directors and oversees agency operations.

Office Assistant: Types reports, arranges conferences and meetings, and acts as the agency's purchasing agent.

Director of Counseling: Directs all intake activities and determines whether a person is eligible to receive counseling services, identifies the proper services, and supervises counselors.

- ***Counselor:*** Provides individual, group, and family counseling according to each client's individual treatment plan.

Director of Education: Performs outreach service to area schools and offers disability education to students, faculty, and other interested parties. Develops curriculum for the education program in the agency and community, and supervises a part-time, in-house educator.

- ***Educator:*** Answers information and referral calls received at the agency; provides school and community education as needed.

Director of Residence: Oversees the residential program, including quality assurance. Evaluates potential residents for admission and supervises residence managers.

- ***Residence Manager:*** Oversees the daily activities of the residence and supervises the residential support staff; ensures 24-hour coverage, and monitors individual treatment plans.
- ***Residential Support:*** Provides direct care to residents, aids them with daily life skills according to their individual treatment plan; ensures that medical, counseling, and work schedules are accurately maintained.

Director of Administration: Oversees finance, human resources, information systems, and grant funding; supervises an accountant and receptionist.

- ***Accountant:*** Performs accounts payable, payroll, general ledger functions; prepares grant vouchers for submission; prepares monthly financial statements for board meetings; provides network support for administration.
- ***Receptionist:*** Answers all telephone calls, schedules clients' appointments, and provides typing support as needed.

Current Salary and Benefits

Position	Current Salary (in $s)	Additional Information
Executive Director	75,000	
Director of Administration	45,000	
Director of Counseling	36,000	
Director of Education	32,000	
Director of Residence	30,000	
Residence Manager	22,000	
Counselor	28,000	Per full-time position
Educator	22,000	Per full-time position
Residential Support	9.00	Per hour
Accountant	28,000	
Office Assistant	12.00	Per hour
Receptionist	8.00	Per hour

Other Expenses

Expense	Amount (in $s)	Additional Information
Rent, houses	1,000	Per month for both houses
Rent, office	2,500	Per month includes utilities
Insurance, Vehicle	1,500	Per year, both vans
Insurance, General Liability	10,000	Per year
Insurance, Board	2,500	Per year
Travel and conferences	400	Per employee
Cleaning, office	1,000	Per year
Office Supplies	13,300	Total from previous year
Depreciation	1,000	Per month
Bank Fees	350	Total from previous year
Meals, board/staff parties	900	Total from previous year
Lease, Copier	190	Per month
Lease, Postage Machine	90	Per month
Lease, Van—North House	400	Per month
Lease, Van—South House	350	Per month
Utilities, houses	275	Per month for both houses
Payroll Service Charge	1,500	Total from previous year
Education, Literature	2,500	Total from previous year
Postage	2,000	Total from previous year
Recreation	750	Per house
Audit Fees	5,000	Per year
Telephone, office	4,000	Total from previous year
Telephone, client	25	Per month per client: residential clients only
Program Supplies, group	350	Total from previous year
Program Supplies, North House	4,500	Total from previous year
Program Supplies, South House	3,000	Total from previous year
Maintenance, North House	1,300	Total from previous year
Maintenance, South House	1,500	Total from previous year

The employees at Extended Family are aware that revenues and expenses must be accurately allocated to individual program cost centers as well as to the administration cost center. Each quarter the Director of Administration must send financial reports to the agencies that provide funding. Reports sent to the state agencies for the counseling and residential programs determine rates of reimbursement that Extended Family will receive in future years. Financial reports sent for the education program are accompanied by narrative program reports regarding the services provided during the reporting period. These reports are used by the funders to determine the continuation and amount of funding to Extended Family and are made available to contributors. Contributors are concerned how expenses are allocated between programs, and they expect to see total administration expenses fall well below program expenses, so that the majority of funds—in particular, their contributions—are provided for services.

Additional information

1. The Executive Director plans a 5 percent salary increase for all current staff in the upcoming year's proposed budget. Benefits cost 18 percent of salaries, and that percentage is expected to continue going forward. The normal workweek is 40 hours for all full-time employees. Currently, the agency budgets salary expense equal to 6.00 full-time equivalent (FTE) employees per house for residential support.
2. Other operating expenses for the upcoming year will not increase. Travel and conferences and supplies are the only expenses that can be reduced if the proposed budget cannot support a continuation of the same amount. If possible, the Executive Director would like to add an employee development day at a cost of $1,500 for a trainer and food.
3. Expenses are allocated directly to the individual programs wherever possible. Office supplies, telephone, and the copier lease are allocated based on the number of staff members in each department. Also, rent and cleaning are allocated on the amount of space occupied by each department. The Education program occupies 25 percent of the building, Counseling occupies 45 percent of the building, and Administration and common areas comprise the balance.

Revenue Sources and Units of Service

There is no anticipated increase in revenue for the upcoming year. Rates for counseling services and residences are determined by the state and are not negotiable. Also, education program grants are in the second year of a three-year contract. Program expansion is limited as indicated below, and interest income on agency cash is expected to continue at $500.

Counseling Program

The counseling program rates are:

- Intake:[1] $150.00 per visit per person
- Individual: $75.00 per visit per person
- Family: $80.00 per visit per family
- Group: $45.00 per visit per person

The Director of Counseling completes an average of 20 intakes per year. Extended Family can bill for an intake visit even if the person is not admitted to the program. All revenue for intakes is considered collectible.

Each counselor can provide individual services to five persons per day, one family visit per month for each family unit, and one support group per week. Each support group has five people in attendance. Also, counselor revenue is 95 percent collectible. Currently, four counselors serve 100 individuals and 100 family units.

Education Program

The education program is funded through the following grants:

- County: $40,000
- United Way: $6,000
- Pharmaceutical: $3,000

The grants provide comprehensive program support for all necessary service-related expenses.

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[1] Intake refers to the initial screening for eligibility into the program.

Residential Program

The residential program rates are:

- South House, 6 residents: $60 per day per resident
- North House, 8 residents: $85 per day per resident

The state pays Extended Family for residents daily as long as the resident spends the night in the house. The residents are away from the house an average of 14 nights per year. Rates are determined through the submission of quarterly interim reports and a comprehensive year-end cost report. Extended Family will not be eligible for increased rates of reimbursement for the upcoming year. The non-eligibility is due to a prior-year special-rate adjustment that enabled the organization to receive increased funding for making non-capitalized purchases and repairs, so residences would meet new regulatory safety codes.

Agency Fundraising—Expansion

The Board of Directors has proposed creating a Public Relations and Development position for the agency in the upcoming budget because the state rates of reimbursement will not increase. In the past, the Executive Director has mailed an annual appeal letter to the family members of individuals who receive services. In this letter, the Executive Director includes a contribution form that allows donors to designate programs for their contributions. Historically, Extended Family has received about $5,500 per year in temporarily restricted contributions. At present, $2,500 remains temporarily restricted as follows:

- $500 for a picnic for individual residents and family members for the counseling program;
- $1,000 for a community-wide disability conference for the education program;
- $200 in a clothing fund to be used either by the counseling or residential staff for individuals in need; and
- $800 for a camping trip for residents in the residential program.

All temporarily restricted funds, with the exception of the community disability conference, are expected to be spent in the upcoming year and should be included in the proposed budget.

The primary responsibilities of the new Public Relations and Development position are:

- Generating a quarterly newsletter
- Creating special events that would be held yearly
- Starting an annual appeal for contributions from community members using a mail solicitation.

In the upcoming year, the annual appeal and one special event, a walk-a-thon, are expected to take place. The Board of Directors understands the effort it takes to coordinate and carry out special events; therefore, they expect that the person in the new position will develop two more fundraising events after a year of service at Extended Family.

The following data represents an estimate of potential revenue and costs generated by the new position. A new office will occupy approximately 2 percent out of the 30 percent administration space and should receive an allocation of other anticipated expenses. In addition, the income generated by the individual should fully support the position and offset some of the deficits the agency now experiences.

Revenue

Annual Appeal	$16,000
Special Event:	
Walk-a-thon Revenue	55,000
Walk-a-thon Expense	(8,000)
Net Surplus	$47,000

Expenses

Salary: $40,000
Benefits: 18 percent of salary
Newsletter: $2,500 per newsletter per quarter
Annual Appeal Letter: $1,000 for printing
Office Supplies: $500 in addition to the budgeted amount allocated
Postage: $1,500 per year

Additional Budget Concerns

Counseling Program

A recent survey by an agency that regulates Extended Family reports a great need in the community for additional group counseling services for individuals with disabilities. Specifically, the survey notes that at least 400 individuals in the community are underserved. Extended Family has also had an increase in referrals for group counseling from other agencies within the community that only provide counseling to individuals. Extended Family wants to maximize its billing and perhaps add an additional counselor to its staff. At present, only three group counseling sessions are conducted each night. However, there is enough space to hire two full-time counselors to provide all services and two part-time counselors responsible only for groups. If the full-time counselors are hired, then the intakes would take place in January and staff would start in February; additional family visits would be equal to the number of new individuals. Also, part-time group counselors could be hired and begin services in January.

Full-time counseling staff is entitled to four weeks of vacation, 12 sick days, and eight paid holidays per year. Newly hired full-time counselors will be entitled to the same amount of vacation, sick, and holiday time. Part-time counselors, meanwhile, receive only the eight paid holidays. While new full-time counselors will be paid the same salary as current counselors, part-time counselor salaries will be a proration of the current full-time salary.

All individuals are assigned to a permanent counselor when they enter the program and will only see another counselor in urgent situations. Vacations and sick days are not considered billable days for individual visits. Family visits would be scheduled around the counselor's time off, and another counselor would provide services for the group. It can be assumed that counseling staff will use the maximum time off allowed when preparing the yearly budget.

Education Program

Extended Family has been asked to make presentations to employers who have employees with disabilities. The Director of Education believes this request can be accomplished with an additional quarter-time employee at a prorated salary of the current full-time rate. In addition to employee and related expenses, $2,000 would be needed for curriculum development costs and $1,000 for advertising. The education staff has not determined the billing rate for this service. However, this additional revenue should be included in the proposed budget.

Residential Program

Three residents, one from South House and two from North House, will move during the upcoming year, and the vacancies will be filled after a two-week period when the units are cleaned and painted. New regulations require two people to be on-site 24 hours per day, instead of the current one-person-per-house staff level. Consequently, two additional residential support staff members must be hired to cover vacations, sick days, and holidays. Residential staff members receive two weeks of vacation, 12 sick days, and eight holidays. The Residence Manager can provide additional coverage for the day shift, but the Director of Residence can be used only for coverage on an emergency basis. The new staff person will be paid $8.00 per hour along with benefits equal to the organization rate of 18 percent.

Fundraising Concerns

The executive and program directors have decided to run a two-week residential summer camp program for 13-year-old and younger individuals served by the organization. The Board of Directors has agreed, as long as (1) all of the funds can be raised from the community and (2) there will be no out-of-pocket costs to family members. Based on similar camp programs, Extended Family needs to raise approximately $25,000. A preliminary review of potential grants and phone contacts with local companies indicates that it is possible to raise at least $15,000 in the upcoming year. The new Public Relations and Development individual will actively solicit the $15,000 but hold the money until the following year when the camp is held.

Maintaining the long-term viability of the organization is a major concern of the Board of Directors. Board members have begun a campaign to establish a permanent endowment and use a portion of interest income for operating expenses. To kick off the campaign, the grandmother of one resident has pledged $100,000 that would be received in two installments in the upcoming proposed budget year.

CASE REQUIREMENTS

1. Using the partially completed spreadsheet in Exhibit 1 and information presented in the case, complete the *current* consolidated operating budget of revenues and expenses for Extended Family, Inc. Distribute the figures to Administration as well as to each of the three existing programs (Counseling, Education, and Residential).
2. Using your output (the completed current operating budget) from Question 1, create a *proposed* consolidated operating budget of revenues and expenses for Extended Family, Inc. Distribute the figures to Administration, Fundraising, and each of the three existing programs (Counseling, Education, and Residential).
3. Allocate Administration expenses in the *proposed* budget to the three programs and Fundraising, and explain the rationale for the allocation procedure you used. Describe at least one other method you considered for the allocation and discuss the effects of this method on the budget for individual programs.
4. Prepare a brief written budget summary to the Board of Directors. In the summary, discuss the assumptions you made when preparing the budget numbers. Include specific comments and documentation regarding the effects the agency expansion and the programmatic concerns have on the proposed budget.
5. The Board of Directors does not want to depend solely on fundraising endeavors to close the budget deficit, and has asked management to examine the organization's operating efficiency and other opportunities for additional revenue. Using the proposed

budget, identify the strategies Extended Family should consider to remain viable. Include narrative and numerical support for your suggestions. The following questions may possibly be considered:

- Should current programs be expanded or closed?
- Should Extended Family consider alternate cost drivers to allocate costs? If so, prepare a revision to the budget completed in questions two and three above, with justification for the new allocations.
- Should the Board of Directors consider an endowment campaign at this time, or should they consider a major campaign and establish a long-term flexible investment plan?
- Should Extended Family provide counseling or group services in an off-site location? If so, prepare a supplemental departmental budget with the anticipated revenue and estimated expenses, and provide a comparison to the proposed department budget from question two above. The average rental property in the area costs $20/ square foot, including all utilities.
- What are some other alternatives Extended Family could consider for its counseling department?
- Should the organization consider adding a for-profit endeavor, such as selling its educational material? If they add a for-profit endeavor, then what is the additional tax-reporting requirement? Where would Extended Family market its material? Should Extended Family hire additional employees for this endeavor, and, if so, what would be their responsibilities?
- To provide more residential service, should the organization add more residences or relocate to larger buildings? Currently, the reimbursement rate for 12 individuals averages $100 per day. Preliminary information indicates the following: rent and utilities would increase 5 percent for the larger residence, client telephone amount would decrease, residential maintenance would decrease to $2,500, and all other expenses would remain the same. If Extended Family should add residences, then prepare a supplemental departmental budget with the anticipated revenue and estimated expenses. Also, provide a comparison to the proposed department budget from question 2 above.

6. Using the proposed operating budget, prepare a pro forma consolidated statement of activities and a pro forma consolidated statement of functional expenses. Include the totals from the current budget as comparative totals for the previous year. On the statement of activities, the previous year's net assets for the beginning of the year were $60,000.
7. A member of the Board of Directors is concerned about the continuing deficit in the residential program and has subsequently asked the Director of Administration to complete an extensive analysis of what is being allocated or directly expensed to the program. He would like you to either (1) develop a way to expense more into the program and force the state to raise rates, or (2) reallocate expenses to other programs that have surplus funds. Prepare a listing of expenses, including the administrative allocation, that are included in the proposed budget in questions 2 and 3 above. Next to each item, indicate whether there is an ethical problem (or not) in shifting costs. Prepare a memo to the Board of Directors with a summary of your findings.

EXHIBIT 1
Partially Completed Worksheet

	A	B	C	D	E	F
1	Extended Family	Current Budget				
2						
3		**Total**	**Counseling**	**Education**	**Residential**	**Administration**
4	**Revenue**					
5	Intake					
6	Individual					
7	Family					
8	Group					
9	Education					
10	Residential					
11	Contributions					
12	Interest Income					
13	Total Revenue	-	-	-	-	-
14						
15	**Expenses**					
16	Salaries					
17	Benefits					
18	Rent, houses	12,000			12,000	
19	Rent, office					
20	Insurance, Vehicle	1,500			1,500	
21	Insurance, General	10,000				10,000
22	Insurance, Board	2,500				2,500
23	Travel/conference					
24	Cleaning, office					
25	Office Supplies					
26	Depreciation					12,000
27	Bank Fees	350				350
28	Meal, board/staff parties	900				900
29	Lease, copier					
30	Lease, Postage Machine					
31	Lease, Van - North House	4,800			4,800	
32	Lease, Van - South House	4,200			4,200	
33	Utilities, house	3,300			3,300	
34	Payroll Service Charge					
35	Education, Literature	2,500		2,500		
36	Postage	2,000				2,000
37	Recreation	1,500			1,500	
38	Audit Fees	5,000				5,000
39	Telephone, office					
40	Telephone, client	4,200			4,200	
41	Program Supplies, group	350	350			
42	Program Supplies, North House	3,000			3,000	
43	Program Supplies, South House	4,500			4,500	
44	Maintenance, North House	1,300			1,300	
45	Maintenance, South House	1,500			1,500	
46	Total Expenses	65,400	350	2,500	41,800	32,750
47						
48	Surplus (Deficit)	(65,400)	(350)	(2,500)	(41,800)	(32,750)

LEARNING OBJECTIVES, IMPLEMENTATION GUIDANCE, AND APPENDIX OF SUPPLEMENTARY NOT-FOR-PROFIT INFORMATION

Learning Objectives

The primary learning objective of this case is for students to allocate costs across multiple programs within a not-for-profit organization. The secondary objective is for students to demonstrate critical-thinking skills and identify solutions that will allow the organization to remain viable. The case simulates the difficulty many not-for-profit organizations experience, with no increase in rates of reimbursement from government funding.

Students fulfill the primary learning objective by completing a current-year operating budget that results in a deficit for the organization. Their next step is to develop a budget for the following year, using specific information that includes both opportunities for the organization as well as constraints. Students then meet the secondary learning objective by developing strategies for the organization to remain viable. Students are given several areas as suggestions for solutions, but are also allowed to offer their own suggestions.

Intended Courses and Audience

The case has been used successfully with graduate students and upper-level undergraduates in a not-for-profit accounting course. If used with students who have limited experience with the not-for-profit area, then helpful prerequisite knowledge would include the basics of not-for-profit accounting regulations, accounting for contributions, and financial statements for not-for-profit organizations. The Appendix of supplementary and background information is included for students lacking this background.

Teaching and Implementation Plan

There are numerous ways faculty can use this case. It has been used successfully as an individual or small group project. Questions 1 through 4 require the students to complete the budget process, while questions 5 through 7 can be added into the project together, separately, or in combinations. Case questions also provide opportunities for classroom discussion before or after students complete the case. Depending upon whether the case is completed individually or within a group, students can complete the case in 10–20 hours, based on student responses to a case questionnaire. We have typically assigned the case as an individual effort when the class size is small, thereby allowing for student presentations. The students are required to present the solution as if they were presenting to the board of directors for their approval. When students are completing the case individually, they are given the assignment at the beginning of the course, with a completion date near the end of the semester.

If the class size is too large for individual presentations or if students enroll in classes during shorter terms, then dividing the class into groups may be more effective. Another option is to have students complete the initial budget in class and then assign them to complete the proposed budget. Additionally, if the requirement to allocate administrative costs is waived, then it is possible to assign an individual or a group the responsibility of completing the case requirements for only one specific cost center. Last, case question 5 pertaining to strategies can be omitted from the case requirements and completed as a class discussion.

Revenue check figures from the current year's budget developed as question 1 may be given to students to ensure they calculate the departmental revenue correctly. Alternately, it may be helpful to review the students' completed current-year budget prior to beginning the proposed budget to ensure students are on track with their revenue. This suggestion will avoid a student or group from having a deficit that is too large.

Students should be reminded to think of reasonableness in creating the budget. For example, students should be encouraged to consider where the organization would place eight more counselors, or who would complete the Director of Administration's duties if this position was eliminated. Students should also not be allowed to include any option that would be considered a one-time, grand gesture, such as an unplanned grant that would eliminate all deficits or receiving contributions that are not specified in the case information. The case specifically states that only one special fundraising event can be included in the proposed budget; however, students often suggest more events and believe that more than one can be accomplished. This issue provides an opportunity for the instructor to discuss the importance of a program's viability and to emphasize that not-for-profits cannot rely solely on an increase in contributions without determining whether their programs are operating efficiently or looking for alternative revenue streams that could be received continually.

Students should submit a written report in addition to the budget narrative. The written report should include formula sheets, similar to those that included in the Teaching Notes, that show how the students calculated the revenue and performed the cost allocations. The written report could also include options the students may have tried and rejected while developing the proposed budget. Since there are many formats for budget and narrative presentation, students should also receive explicit presentation guidelines. Any local convention of not-for-profit fees may also be incorporated into the case, so students develop a realistic approach from their community.

Classroom Validation

This case has been used successfully with graduate classes in Budget and Financial Management of Human Service Organizations, and undergraduate courses in Government and Not-For-Profit Accounting. One objective of the courses was to develop, use, and evaluate budgets as they relate to the goals of a human service organization. The students in the graduate program typically have an undergraduate degree in social work or sociology.

Classroom experience indicates that students will comment on the intensity of the case, to which we would agree, so they should be encouraged to take the case one step at a time to make it more manageable. In course evaluations, all students agreed that the goals of the course had been met. Specifically, close to 70 percent of the students in the class commented that this case was the most beneficial part of their learning. At the time of this writing, the average student rating of the course question "the assignments/projects/papers helped me to develop a better understanding of course contents" is 6.7 out of a maximum ranking of 7 (strongly agree).

After the Fall 2004 graduate class and Spring 2005 undergraduate class completed the case, students were given a questionnaire and asked to rate their perceived knowledge related to budgeting, cost allocation, and making major programmatic decisions prior to completing the case and after completion.

Of the students responding, 59 percent of the undergraduates were neither currently employed nor were they ever employed in a not-for-profit organization. All of the graduate students were employed in a not-for-profit organization, primarily between one and five years and in positions that were either direct service or direct service with partial administration. The undergraduate students completed the case in small groups, and the graduate students completed the case individually. There were no significant differences in the questionnaire responses based upon student level of education or employment.

The following table represents the percentage of responses related to student self-assessment of their knowledge prior to completing the case. The respondents selecting "very poor" were all graduate students.

	Very Poor	Poor	Fair	Good	Very Good
My knowledge of budgeting was ...	12.5	8.3	54.2	25.0	0
My knowledge of allocating direct costs was ...	12.5	16.7	41.7	20.8	8.3
My knowledge of allocating overhead costs was ...	12.5	16.7	50.0	16.7	4.1
My experience in making major programmatic decisions was ...	8.3	20.8	54.2	12.5	4.2

The following table represents the percentage of responses related to student self-assessment of their knowledge after completing the case.

	Very Poor	Poor	Fair	Good	Very Good
My knowledge of budgeting is ...	0	0	4.2	58.3	37.5
My knowledge of allocating direct costs is ...	0	0	12.5	62.5	25
My knowledge of allocating overhead costs is ...	0	0	16.7	54.2	29.1
My experience in making major programmatic decisions is ...	0	0	20.8	58.4	20.8

APPENDIX
SUPPLEMENTARY NOT-FOR-PROFIT INFORMATION

This supplement provides information on not-for-profit organizations that may be helpful for students completing the case. The information is categorized based on the case questions.

Questions 1, 2, and 3

These questions address creating a budget that includes cost allocations and contributions. Information related to cost allocations can be accessed from any cost accounting textbook. However, allocations specifically related to not-for-profit organizations can be reviewed using *GAAP for Not-For-Profit Organizations*, OMB Circular A-122, or other sources listed in the bibliography. OMB Circular A-122 is specific to federal contracts, but stands as a basis for other funding groups to use in determining allowable costs for reimbursement. In addition to proving guidance for direct and indirect cost allocations, it also provides guidance on allowable costs. For example, OMB Circular A-122 includes the following information for public relations costs:

The term public relations includes community relations and means those activities dedicated to maintaining the image of the organization or maintaining or promoting understanding and favorable relations with the community or public at large or any segment of the public.

The only allowable public relations costs are:

(1) Costs specifically required by sponsored awards;
(2) Costs of communicating with the public and press pertaining to specific activities or accomplishments that result from performance of sponsored awards (these costs are considered necessary as part of the outreach effort for the sponsored awards); or
(3) Costs of conducting general liaison with news media and government public relations officers, to the extent that such activities are limited to communication and liaison

necessary to keep the public informed on matters of public concern, such as notices of contract/grant awards, financial matters, etc.

Accounting for contributions is covered in detail in SFAS No. 116. Basically, contributions received by not-for-profit organizations are classified as unrestricted, temporarily restricted, or permanently restricted. The classification is driven by the contributor's intention and imposed restriction. If a donor sends a contribution requesting that it be restricted to a purpose that is within the organization's general purpose, then that contribution would not be considered restricted. For example, a donor sends a check to an organization that provides community education for eating disorders, good nutrition, and benefits of organic food. The donor sends a note with the check stating that the check should be used for good nutrition education. Since that request meets one of the organization's purposes, the contribution is not considered restricted.

Temporarily restricted contributions are donor-restricted for a specific purpose. They are recorded as temporarily restricted revenue and only "released" when the purpose has been met. The purpose may be met through the passage of time or after a specific act has occurred. For example, a donor sends a contribution to be used to purchase a computer. When the organization buys the computer, the organization will release the amount from the temporarily restricted funds. Another example would be a donor sending a contribution that could be used after it gained 60 days of interest. The organization would release that money from temporarily restricted funds on day 61. Permanently restricted contributions, generally endowments, can never be released from restriction. In many cases endowments are established for the purpose of ensuring ongoing financial support through the use of the interest earned on the funds. Only the donor can establish restrictions. If a board of directors decides to set unrestricted money aside as an endowment, then it is considered a quasi-endowment and is reported as unrestricted contributions.

Contributed services are also recorded by the organization only if the services being provided require special skills and would have been purchased by the organization, such as accountants or lawyers. To record these contributions the organization would determine the fair market value, or the amount they would pay if they were to hire an individual on their staff to provide the service. If the organization would not have purchased the services provided by the contribution, then they do not need to be recorded.

Question 5

Question 5 requires students to list strategies for the organization to remain viable. The suggestions listed are the authors' ideas, and students should be encouraged to think of alternate solutions and not be limited to the ideas listed in the case. The only suggestion listed in the case that requires additional information from outside sources is related to the pursuit of a for-profit endeavor. If students consider that option, then they are also asked for information regarding the additional tax-reporting requirement. If the unrelated activity is one that is regularly carried on and has income of $1,000 or more, then the organization must complete a 990-T and pay tax on that income. An activity that is regularly carried on is one that is frequent or continual.

Determining whether the activity is related to the exempt purpose is also based on whether it contributes importantly to the purpose. The IRS Publication 598 includes many examples of activities that have been determined to be related or unrelated to an organization's exempt purpose.

Question 6

Question 6 requires students to prepare a pro forma Statement of Activities and Statement of Functional Expenses. The full requirements for reporting can be found in SFAS No. 117. This statement also required a new model, the net asset model, to be used in financial reporting. Under this model, revenue increases the organization's assets, and expenses decrease the assets.

The Statement of Activities is the summary of revenue and expenses and is reported with categories for unrestricted, temporarily restricted, and permanently restricted funds. An additional statement, the Statement of Functional Expenses, accompanies the Statement of Activities and is used to report revenue and expenses categorized by major program.

Question 7

Question 7 is an ethical question related to cost allocation in cost reports for rate reimbursement. Using their own comfort in shifting costs, students are asked to complete the board members' request. There have been many instances in the not-for-profit industry, and in particular in health care, where costs have been inflated leading to overpayments to health care providers. In 1998 the Office of Inspector General mandated corporate compliance programs for hospitals, and subsequently for other health care facilities. Since one of the reasons for the compliance program was to prevent fraud, many other regulatory organizations have required other non-healthcare related organizations to follow a compliance program. Below is an excerpt taken from the *Federal Register*, Vol. 63, No. 35, Monday, February 23, 1998, regarding cost reports as related to a compliance program:

> *d. Cost reports.* With regard to cost report issues, the written policies should include procedures that seek to ensure full compliance with applicable statutes, regulations and program requirements, and private payor plans. Among other things, the hospital's procedures should ensure that:
>
> - Costs are not claimed unless based on appropriate and accurate documentation;
> - Allocations of costs to various cost centers are accurately made and supportable by verifiable and auditable data;
> - Unallowable costs are not claimed for reimbursement;
> - Accounts containing both allowable and unallowable costs are analyzed to determine the unallowable amount that should not be claimed for reimbursement; and
> - Costs are properly classified.

TEACHING NOTES

Teaching Notes are available only to full-member subscribers to *Issues in Accounting Education* through the American Accounting Association's electronic publications system at http://www.atypon-link.com/action/showPublisherJournals?code=AAA. Full-member subscribers should use their personalized usernames and passwords for entry into the system where the Teaching Notes can be reviewed and printed.

If you are a full member of AAA with a subscription to *Issues in Accounting Education* and have any trouble accessing this material, then please contact the AAA headquarters office at office@aaahq.org or (941) 921-7747.

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ADDITIONAL RESOURCES

- *Internal Revenue Publication 598 (Rev March 2000).
- *Internal Revenue Service website, http://www.irs.gov.
- The Chronicle of Philanthropy website. http://philanthropy.com/
- *Joint Program and Fundraising Costs AICPA SOP 98-2
- Excessive Benefits and Executive Compensation IRS Code 4958
- Office of Inspector General website http://oig.hhs.gov/
- Association of Fundraising Professionals http://www.afpnet.org
- *OMB Circular A-122 Cost Principles for Non-Profit Organizations http://www.whitehouse.gov/omb/circulars/a122/a122.html

*Contain information that is the most helpful for students who have a limited background in not-for-profit organizations.