

17. EXPENSES

17.1 Description

Expenses are gross decreases in assets or gross increases in liabilities (or a combination of both) recognized and measured from rendering services, delivering or producing goods, or carrying out other activities that constitute the NPOs ongoing major or central operations. While revenues increase net assets, expenses decrease the net assets of an NPO.

When determining the net excess or deficit for the period, the following pervasive principles are considered:

- a. Associating cause and effect – where costs are recognized on the basis of a presumed direct association with specific revenue which means that costs are charge to expense in the period that the revenue with which they are associated is recognized.
- b. Systematic and Rational allocation – wherein the absence of a direct means of associating cause and effect, some costs are associated with specific accounting periods as expenses on the basis of an attempt to allocate costs in a systematic and rational manner among the periods in which benefits are provided.
- c. Immediate recognition – the cost is immediately expensed.

17.2 Classification of NPO Expenses

Natural Classification of Expenses

This refers to the enumeration of expenses that includes expense categories such as salaries, rent, electricity, etc. This may not reflect the services, programs, projects of an NPO which reflect its goals and objectives.

Functional Classification of Expenses

Expenses are classified in relation to the major classification – programs/projects, administrative, fund-raising. This practice classifies all costs according to different functions of the NPO.

It is recommended that for NPOs, expenses must be presented by functional classification in the Statement of Activities. Functional reporting, as its name implies, describes the activity for which the NPO incurs an expense. The functional classification of expenses is as follows:

- a. Program/Project expenses
- b. Administrative expenses, which are further classified as:
 - General expenses
 - Human resource development (includes Training Expenses)
- c. Fund-raising expenses

Definitions of Functional Classification:

- a. **Program/Project Expenses** – relate to those program service activities that result in services (or goods) being distributed to beneficiaries or members that fulfill the basic mission of the NPO. An organization can have more than one category of program services.

Program services expenses are those amounts specifically expended in support of activities that directly advance the organization's nonprofit mission. In other words, if an organization exists to promote the development of a cure for AIDS, amounts spent in grants to AIDS researchers is a program services expense.

- b. **Administrative Expenses**

General Expenses – relate to activities such as oversight management, general record keeping, office maintenance, and similar expenses.

Human Resource Development – pertains to expenses incurred for the purpose of developing and consolidating the NPO's board of trustee, management and staff.

- c. **Fund-Raising Expenses** – are those expenses incurred in encouraging donors to contribute to the NPO. Fundraising expenses are those amounts used to bring in additional revenue, typically (but not only) through public donations. An example of fundraising expenses are the costs of printing and mailing to the general public flyers that encourage them to support the organization's mission by sending a donation.

Important Note:

Personnel and other costs traceable to a specific program should be part of program costs. Administrative personnel and overhead costs are part of Administrative expenses.

Practical Examples

- a. Conducted training to co-operators and the following expenses were incurred:

Training Venue	Php 10,000
Travel and Transportation of co-operators	5,000
Accommodations and meals	45,000
Lecturers Honoraria	<u>15,000</u>
Total	<u>Php 75,000</u>

	<u>Debit</u>	<u>Credit</u>
Project Expenses – Co-operators Training	75,000	
Cash		75,000

- b. Professional fees paid for Writers – 20,000

	<u>Debit</u>	<u>Credit</u>
Project Expenses – Professional Fees	20,000	
Cash		20,000

- c. Supplies and materials were procured for 10,000

	<u>Debit</u>	<u>Credit</u>
Administration Expenses – Supplies & materials	10,000	
Cash		10,000

- d. The Project pays the monthly rental - 40,000

	<u>Debit</u>	<u>Credit</u>
Administration Expenses – Office rent	40,000	
Cash		80,000

- e. Paid salaries of Project management staff 200,000

	<u>Debit</u>	<u>Credit</u>
Administration Expenses – Personnel cost	200,000	
Cash		200,000

- f. Conducted staff development training – total expenses = 50,000

	<u>Debit</u>	<u>Credit</u>
Human Resource Dev't – Staff Development training	50,000	
Cash		50,000

- g. Incurred fund-raising expenses, raffle tickets - 20,000

	<u>Debit</u>	<u>Credit</u>
Fund Raising Costs – Materials	20,000	
Cash		20,000

A Schedule of Expenses using the functional classification can be presented in this format:

ACCOUNTS	PROGRAM/ PROJECT EXPENSES	ADMIN EXPENSES	FUND- RAISING EXPENSES	TOTAL
Sub-total				
Sub-total				
TOTAL				

17.3 Allocation of Joint Costs

This addresses a situation where a cost incurred by an NPO relates to two or more different activities. The cost is allocated and reflected in the financial statements, with a particular impact on the functional reporting in the statement of activities.

Joint costs and indirect costs are allocated to programs and support services. There are three criteria permitting cost allocation:

- Purpose criterion
- Audience criterion
- Content criterion

Purpose criterion is met if the purpose of the joint activity includes two or more programs or support services.

Audience criterion is met if the target audience or beneficiaries includes two or more programs or support services.

Content criterion is met if the joint activity supports program or support services

There are ways of allocation. However, ***the adopted allocation method should form part the accounting policies of the NPO and should be applied consistently for the same type of transaction until the policy is revised.*** The following are some of the methods:

- Physical units method. This method allocates costs based on the physical materials that make up the joint costs.
- Relative direct method. This method allocates joint costs in relation to the direct costs of each of the activities.

- c. Stand-alone cost method. This method allocates joint costs to each component of the joint activity on a ratio that estimates the costs that would have been incurred had the joint activity been performed separately

Many NPOs practice allocating joint costs using any or combination of the following:

- a. Equal allocation. Each project shares equally.
- b. Budget-based allocation. Costs are allocated on overflow basis, starting with the project that has the lowest budget.
- c. Size-based allocation. Size may be measured by:

Allocation Base	Unit
Staff	Persons
Office Area	Square Meter
Vehicle Usage	Mileage/Kilometers Used
Phone Extension	Numbers
Phone Calls	Call Units
Grant Size	Local Currency/Equivalent
Beneficiaries	Persons
Field Area	Villages

To facilitate the task of allocating joint-costs, an allocation worksheet can be prepared:

COST HEADING	TOTAL AMOUNT	ALLOCATION BASIS	CALCULATIONS	AMOUNT ALLOCATED			
				ProjectA	ProjectB	ProjectC	Total