

# Thrive Non-Profit Success Stories | Functional Expense Accounting for Non-Profits | Transcript

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Patrick Frambes:

One of the topics that we had talked about from a technical standpoint was functional expense accounting. I feel like we get a lot of questions from our clients as functional expenses are a requirement to incorporate in any GAAP basis financial statement for a non-profit. Also, a very important schedule that's on the Form 990. So I know a lot of donors look at this to determine how the organization is using their funding. Maybe speak a little bit about your thoughts on that, maybe some benchmarks that might be important, and also any guidance that you've provided to clients in the past as well.

Christa Woelfel:

Yeah, absolutely. So, functional expenses a handful of years ago became required for all non-profit organizations. And it is a very important schedule because not only do we include this as part of the audit report, but it also is made publicly available on all the 990s, as you mentioned.

So within the statement of functional expenses, we have to make sure we not only present the expenses by their natural classification, which could be salaries, rent, office supplies, but by their functional classification, which is going to be three categories. It's going to be program, management in general, and fundraising.

So we've worked with a lot of non-profits over the past handful of years to really refine this process and make sure that it's comparable year over year so it's apples to apples. However, if there's a change in the programs, the operations, the staffing, we want to make sure they're looking at that every year to make those changes.

So, for example, the president or CEO of the organization probably isn't going to fall into just one category. President or CEO, they'll be doing some fundraising, meeting with donors. They'll be in programs some, they'll also be in administrative function some. So we want to make sure we're looking at that every year. It is an estimate. It's all judgment-based. So we want to make sure there's some consistency, but we are modifying that when needed.

Patrick Frambes:

Okay. And how detailed of a process did that client have to go through in order to determine how much of their time is spent in a program versus admin or fundraising?

Christa Woelfel:

Yeah. So a lot of times, some expenses are cut and dry, which category it's going to be in. If you got supplies for one of your programs, it's 100% program. But there are some expenses that you have to allocate between all three. You mentioned employee time. That's a huge one. A lot of times, we recommend that clients are tracking time on time sheets for different programs.

If it's administrative functions, or fundraising, or based on the role, they have a good general idea of where their time is being spent. That's usually a good way to allocate your time is the estimated time spent. If you're out fundraising, meeting with donors, that's going to be fundraising. If you're doing more administrative function, it's going to fall on admin.

You'll also probably have some program time as well. Some other expenses that we see allocated are going to be our space costs, maybe depreciation expenses, any rental expenses and usually we recommend that is allocated based on the square footage. However, you're using your space; you know this much is going to be for our administrative offices. This much is going to be for our programs. Maybe the development or advancement team has this many square feet. So that's another good estimate that we see used.

Patrick Frambes:

Great. And as far as benchmarks, do you have any general benchmarks? I know every non-profit is different in how they operate, but I don't know if you have any thoughts on benchmarking related to functional expenses.

Christa Woelfel:

Definitely. So for functional expenses, there's really two big watchdogs out there. The Better Business Bureau likes to see 65% or higher of all of your expenses being allocated to program. United Way likes to see that at 75% or higher. So those are the two watchdogs who like to see where those benchmarks are, so that's usually what we go on.

Patrick Frambes:

Okay, great. Yeah. And obviously, every organization is different in how they operate. Peer-to-peer comparisons are important too.

Christa Woelfel:

Absolutely.

Patrick Frambes:

So you mentioned the 990 being publicly available. You can get that on [guidestar.org](http://guidestar.org) or on the IRS's website. So, as organizations are looking to compare themselves, they can maybe pull an organization that they're similar to them in their own city or regionally and compare themselves to those other non-profit organizations as that information is available. I always do like to remind my clients, though, that

because there are significant estimates and judgments incorporated, it's not always an apples to apples comparison. So just take it with a grain of salt, but use it as a form of judgment just to be able to understand where you stand and stack against your peers.

Christa Woelfel:

Definitely.

Patrick Frambes:

With respect to donors, I know donors look at the functional expenses as well. Any thoughts on how a donor should perceive an organization that maybe has no fundraising costs or has very little admin? Is that a great thing or a good thing for an organization, or is that something that maybe needs to be watched?

Christa Woelfel:

I would say it's not necessarily a good or bad thing because everything is situational, but for donors, they want to see a lot of times the number, how much of that \$1 they're giving is going to programs. But as you mentioned, it's all judgment and estimate-based. So if you're a donor giving to an organization and you know they are getting donations, there should be some sort of fundraising cost. And we know organizations cannot operate without the administrative team, so I would always expect there to be some sort of administrative cost as well. A lot of times, we do see during periods of growth, the administrative costs being higher in those years as they really try to build up their support team.

Patrick Frambes:

Yeah. Great. Thank you.