A Nonprofit Guide to Restricted Funds

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Donor-restricted gifts can fuel programs, launch new initiatives, and help your nonprofit serve more people. They also come with an important responsibility: making sure every dollar is used as the donor intended and reported accurately.

Fortunately, restricted revenue accounting does not have to feel overwhelming. With a consistent process and a dependable restricted net asset schedule, your finance team can stay organized, protect donor intent, and make audits and reporting far less stressful.

1. *Let the Donor Agreement Lead the Way*

Before recording revenue, pause and review the grant agreement, award letter, pledge, or donor correspondence. Three questions guide the accounting:

- Is the transaction a contribution or an exchange transaction?
- Is the contribution conditional or unconditional?
- Does the donor restrict the gift by purpose, time, or both?

A **condition** is more than a spending limitation. It generally includes both a barrier the nonprofit must overcome and either a donor-imposed right of return of transferred assets or a right of release from the donor's obligation to transfer assets. Until the condition is substantially met, contribution revenue is not recognized. Cash received in advance is generally recorded as a refundable advance or other liability.

A **restriction**, by contrast, tells the nonprofit how or when an unconditional gift may be used. These gifts are generally recorded as revenue within **net assets with donor restrictions**. A board designation is not a donor restriction because the board can usually change it.

2. *Give Every Restriction a Clear Home*

Create a unique grant, project, fund, or restriction code for each gift that needs separate monitoring. Then use that code everywhere – from the initial contribution and receivable to cash receipts, expenses, and releases. Consistent coding is one of the simplest ways to prevent confusion later.

Keep a central file with the agreement, a plain-language summary of the restriction, the performance period, approved budget, amendments, expense support, release calculations, and donor reports.

3. *Match Spending With the Right Release*

Record qualifying costs using their normal natural and functional classifications. When the donor's purpose has been fulfilled, or the specified time period has elapsed, record a **release from restriction**. Think of the release as moving resources from one net asset class to another. It is not new revenue, and it is not an expense reversal.

Here is a simple example: your nonprofit receives a $100,000 unconditional gift restricted for a youth program and uses $35,000 for qualifying program costs. The accounting generally includes:

- $100,000 of contribution revenue with donor restrictions when the gift is recognized;
- $35,000 of program expense when the costs are incurred; and
- a $35,000 release from restriction when the donor's purpose requirement is satisfied.

4. *Make the Restricted Net Asset Schedule Your Go-To Tool*

Your restricted net asset schedule should be more than a year-end worksheet. Used well, it becomes the finance team's control center for donor-restricted activity. Maintain it by individual grant or restriction and reconcile it to the general ledger throughout the year.

Basic rollforward: Beginning restricted net assets + restricted support and other additions − releases = ending restricted net assets.

Recommended fields for a restricted net asset schedule		
Identification	**Activity**	**Monitoring**
Donor, award, project code, restriction purpose, and performance period	Beginning balance, contributions recognized, other additions, releases, and ending balance	Receivable, cash received, qualifying expenditures, remaining budget, release support, and reporting status

Keep award budgets, cash, receivables, refundable advances, and restricted net assets in separate columns. They may be related, but each answers a different question. Keeping them separate makes unusual balances easier to spot and explain.

5. *Reconcile Regularly, Not Just at Year-End*

- Agree beginning balances to the prior-period schedule.
- Match restricted contribution revenue to the general ledger and donor agreements.
- Review expenses for eligibility, timing, coding, and allocation.
- Identify purpose restrictions satisfied and time restrictions that expired.
- Prepare and approve release entries with supporting documentation.
- Reconcile the ending restricted balance to the trial balance and financial statement disclosures.
- Investigate negative, stale, overspent, or otherwise unusual balances.

6. *Build Strong Controls*

Good controls do more than satisfy auditors – they help your nonprofit use donor funds confidently and responsibly. Finance should review new agreements and amendments before transactions are recorded. Limit who can create account codes, require support for unusual or shared costs, review budget-to-actual reports with program personnel, and separate the preparation and approval of releases when practical.

Restricted fund accounting is a team effort. Development, program, finance, and legal personnel should resolve unclear donor language early. The accounting records should reflect the donor's documented intent, not an informal internal understanding.

Watch Out for These Common Pitfalls

- A conditional award is recognized as revenue too early.
- A board designation is treated as a donor restriction.
- Restricted cash is confused with net assets with donor restrictions.
- Qualifying expenses are recorded, but the related release is overlooked.
- Cash spent is used as the release basis even when the donor requirement specifies a different basis.
- Old or negative balances remain without investigation.

The strongest restricted revenue processes make the donor agreement, general ledger, expense support, release entries, and restricted net asset schedule tell one clear story. Review agreements early, code transactions consistently, document releases, and reconcile throughout the year. These habits support proper reporting, but just as importantly, they protect donor intent and strengthen stewardship.

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