

# McLean, Koehler, Sparks & Hammond

Certified Public Accountants/Business Consultants

## Nonprofit Organizations

### Classifying donations important recordkeeping task

*Good News: We received a million dollar donation!*

*Bad News: It's all restricted!*

While we would all like to receive unrestricted donations, the majority of donations are restricted – they come with some sort of strings attached.

Donations to nonprofit organizations may be given as either:

- Unrestricted – The money is given with no strings attached. The organization can use the money as it sees fit.
- Restricted – The gift is made for a specific purpose. Restricted funds can be further broken down into “permanently restricted” (i.e., forever can be used only for the purpose the donor specified) or “temporarily restricted” (i.e., donor restricted for use until a specific event occurs or until a certain amount of time has passed).

If a gift is received with donor-imposed restrictions, it should be recorded on the books as restricted funds with a notation of whether the funds are permanently or temporarily restricted. When donor-imposed restrictions have been satisfied, these funds can be released to the unrestricted funds category.

Misuse of restricted funds is illegal and can lead to fines and/or imprisonment depending on the magnitude of the infraction.

Nonprofit software has progressed to the point where income and expense for different funds can be tracked fairly easily.

For example, by using the “Class” function in QuickBooks, you may track all of the income and expense for a particular restricted fund. This is important for reporting purposes. Misuse of restricted funds is illegal and can lead to fines and/or imprisonment depending on the magnitude of the infraction.

A nonprofit organization found to have misused restricted funds will also find both contributors and lenders reluctant to provide it with capital long after the guilty are punished. The organization will have to prove it can handle money responsibly before donors or financial institutions provide additional funding.

Occasionally, accidental or inadvertent misuse occurs when a restricted fund was charged in error. The error should be rectified as soon as discovered, and the fund should be repaid immediately. This unfortunate mistake is far different from an \$800,000 scholarship fund that is restricted to award scholarships but awards only \$500,000 worth of scholarships.

That being said, you want your restricted funds to be as general and as all-encompassing as possible. If a donor desires to give \$10,000 for “Program A,” but the organization already has a program in place that does a good deal of what Program A would do, you might be better off persuading the donor to donate to the existing program. Then, have the existing program highlight some of the areas the donor feels are crucial instead of starting a redundant program.

Consider the case of one nonprofit organization with approximately 225 restricted funds that ranged in size from several million dollars down to \$35. The Beacon Light Fund was established by one donor who wanted to have the exterior of the nonprofit’s facility lit at night, for both aesthetic and safety reasons. Unfortunately, the donor did not have the financial resources to contribute more than \$35. With approximately 225 other funds requiring the director of development’s attention, it’s easy to understand how this fund languished for years with no additional contributions.

While the cause was worthy, \$35 was not enough to pay for one light bulb, much less the fixture, the wiring and electrician needed to install the fixture.

The fund for the lighting grew slowly each month as the organization's accountant added a nominal amount of interest. When the fund reached its pinnacle, it approached a whopping \$38.50. Happily, the fund was combined with four or five other small funds with similar restrictions, and the beacon light was purchased and installed.

Although this story had a good ending – the light did make the building grounds much safer at night, permitted evening events outdoors and was aesthetically pleasing – consider that, if those five or six funds had been classified as one general building improvement and safety fund from the start, the light could have been installed years earlier.

The donor had plenty of time to be upset that he had contributed to a project and years had elapsed without anything happening. Of course, this makes him a poor candidate for the next fundraising drive. And, there's the accountant who every month had to add a few cents interest to this restricted fund – not exactly a good use of time.

By keeping the classifications more general from the start, the nonprofit organization would have had better control of its expenditures.

Give our firm a call today. We can shine a beacon light on how your nonprofit can operate more efficiently.

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McLean, Koehler, Sparks & Hammond helps owners and business leaders become more successful by providing innovative financial, technology and management solutions for every stage of their organizations' life cycle. For more information on this article or MKS&H, please send an email to [info@mksh.com](mailto:info@mksh.com) or call 410.296.6200 and the marketing director can put you in touch with the right department.

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