

How to track, allocate, and report funding for restricted activity

It is important to distinguish between unrestricted and restricted funds. Put simply, restricted funds have been given to a charity for a particular reason and can only be spent in accordance with the requests of the donor. Failure to do this may be a breach of trust.

Restricted funds can be split further into two categories: restricted income funds and endowment funds. The latter are funds received by a charity that represent capital and which charity law requires trustees either to invest, or to retain and use for the charity's purposes.

Unrestricted are funds that a charity has received which are not held for any specific charitable purpose. They can be spent as deemed fit by the trustees and can include designated funds, which are unrestricted funds that the trustees have set aside for a particular purpose. Such funds can be undesignated or re-designated at any time.

Types of funds:



Fund accounting is a concept unique to charities and is used to determine and report how much money is in each fund, as well as when and how it has been spent. Fund accounting splits financial activity into different pots depending on the purpose of the donation.

Adhering to the principles of fund accounting is critical and charities must ensure financial statements are clear on issues relating to funds. These principles are fundamental to trust law and are not merely statutory accounting requirements.

1. Establish what is genuinely restricted income

Review your income and determine which is restricted and unrestricted based on the definitions outlined above. While a grant awarded for a one-off project may be easy to determine, donations could be less so. The key is the donor's intention when making the gift.

Ask yourself: "What obligations did the donor intend to impose on the recipient of the gift with regard to its use?" If there are no indications that the donor had any specific intention, a gift can be treated as unrestricted income. Use your accounting system to allocate income to different pots.

2. Implement a restricted fund tracking process

Tracking restricted funding is an important exercise and shouldn't be dismissed as a year-end accounts process. Keeping track during the year will allow better monitoring of financial performance, and help you set and review your reserves policy.

Not identifying restricted income at the time of donation, and subsequently not allocating expenditure to restricted funds until the year-end, can have a distorting impact on planning and budgeting. An expectation that available funds are greater than the true position could result in planning additional activities thinking the reserves are available to fund them.

Ongoing tracking could also reveal a lack of diversity in your funding streams. Knowledge that the majority of income received is in the form of restricted grants and donations means you may want to consider looking at other sources of funding.

3. Revisit restricted funds

If many years have passed since a restricted fund was established, or the fund is no longer relevant, consider your options for changing the status of the fund. There are specific regulations governing the management of funds so you will need to ensure you're following the law and have the relevant permission from the Charity Commission if a donation classification needs to change.

4. Determine the components of funds

Having recognised that income received for a particular purpose must be used only for that purpose, it is necessary to also allocate expenditure against these funds. Expenditure needs to be analysed in a way that enables a proper calculation of what has been spent and what can be carried forward as a balance on the restricted funds.

Costs of administering and raising funds should be charged to that fund, usually by treating the income as restricted and charging the costs of generating the income to restricted expenditure. Charging these costs to general funds is inconsistent with the principles of fund accounting.

5. Analyse assets and liabilities

To understand the status of the fund and how much is left to spend it is important to analyse the fund's assets and liabilities and ensure that these are kept in balance. Ideally assets should be structured in such a way that short term liabilities and restricted funds for short-term application are matched with short-term assets and investments.

In practice, knowing exactly what is included in the fund balance can be difficult and a better approach may be to create an assets and liabilities table, filling in the known amounts and using a balancing figure approach to complete it.

6. Include overheads in restricted fund costs

Unrestricted funds are often seen as the holy grail of charity financing, since they can be spent as trustees deem appropriate. There is sometimes a mistaken belief that restricted funds cannot be used towards central overheads or support costs.

Along with income and all direct costs, overheads should be apportioned to restricted funds through the year. Not doing this may mean by the end of the year the restricted funds have been spent, resulting in overhead costs being funded out of unrestricted reserves.

7. Ensure accurate reporting

Whatever types of restricted funding you have, you will need to report it appropriately in your financial statements, as well as internally to trustees. You should distinguish between restricted and unrestricted funding in your Statement of Financial Activities and balance sheet.

8. Produce donor reports

Often when restricted funds are awarded to a charity, the donor asks for a report on how funds have been spent. Donor reports will not necessarily coincide with your accounts year-end. You need to make sure that you can easily identify the expenditure connected to each restricted fund at any time during the year.

Using your accounting system to allocate income and expenditure to a particular department, project, or cost centre should make extracting the information for the donor report more straightforward. Modern, cloud-based accounting software can greatly assist charities in reporting on funds, as well as monitoring activity on an ongoing basis.

9. Seek professional advice

Fund accounting can be complex, so it might be best to use an accountant experienced with charities to ensure regulatory compliance when preparing year-end accounts. Generally accepted accounting procedures must be followed. You may need to consider more technical accounting concepts in how restricted funding is recognised and allocated.

The importance of reviewing accounting systems and resources

Charities will need to review their systems to improve processes, stay up-to-date with tech developments, and ensure compliance. You should regularly ask yourself the following questions:

- Is your accounting system still fit for purpose?
 - Are you making the most of its functionality?
 - Is your system able to monitor funds throughout the year?
- Do your staff performing accounting tasks need training?

Once you've asked those questions, you will need to decide on actions. You may need to make changes based on your conclusions, such as upgrading systems, upskilling staff, uncovering greater functionality, and so on.