

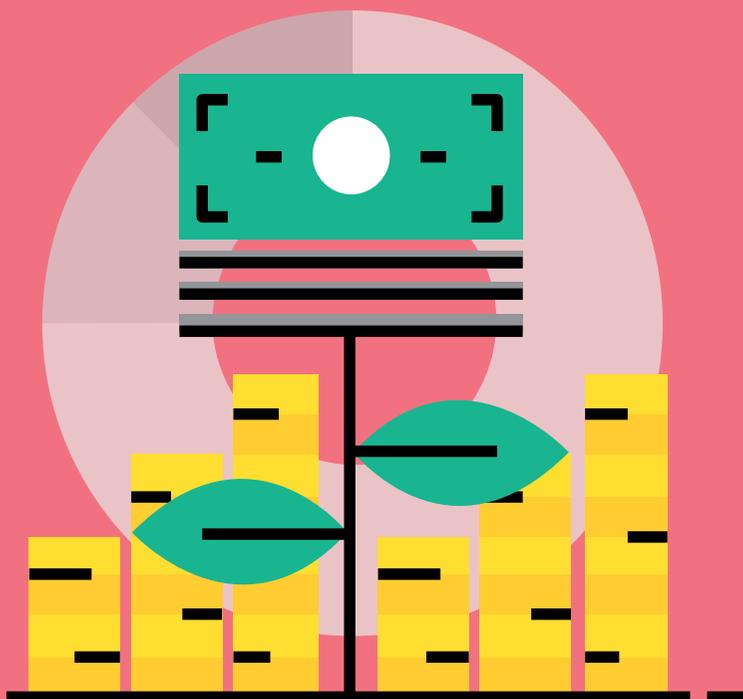
# CPAs for NGOs

## Social Responsibility Programme

Quick Guide Series



# Reserve Policy



Hong Kong Institute of  
Certified Public Accountants  
香港會計師公會

## Introduction

The Hong Kong Institute of CPAs has organized a series of “CPAs for NGOs” seminars to help local small- and medium-sized social service / non-governmental organizations improve their financial management and reporting, budget planning, internal control, and governance. Highlights of these seminars are captured in a series of quick guides designed to facilitate the implementation of best practices in your organization. For a full set of presentation slides, please go to [www.hkicpa.org.hk/CPAforNGO](http://www.hkicpa.org.hk/CPAforNGO).

## What is a reserve policy?

- ***A reserve policy is an official statement about***
  - purpose of maintaining reserve
  - target reserve level and the rationale of setting such level
  - prerequisite for utilizing reserve and the procedure
  - review mechanism
- ***NGOs normally manage more than one reserve fund***
  - Each reserve fund is subject to different regulations (e.g. Lump Sum Grant Manual) and circumstances (e.g. donor’s designated or intended purpose)
- ***A reserve policy should be developed for each category of reserve:***
  - Lump sum grant reserve
  - General fund reserve
  - Designated fund reserve



## Why NGO needs a reserve policy?

- In principle, income fund should be spent within a reasonable period of time upon receipt for the intended purposes
- Reserve is unspent income fund that NGOs should manage to maximize the use of it to maintain or strengthen service delivery and implement strategic plans
- If the NGO holds substantial reserve, the funders, grant-makers, donors and other stakeholders may think it:
  - ✗ not providing sufficient social services
  - ✗ not providing quality social services
  - ✗ not keeping abreast of the societal needs
  - ✗ not innovating the way in service provision
  - ✗ not capturing new service opportunities
  - ✗ not controlling cost at a reasonable manner

## Purpose of a reserve policy

- Enabling of sound financial management
- Demonstration of financial and service sustainability
- Ability to forward service planning
- Indicator of future funding needs
- Management of reputational risk from holding substantial reserve



## How to develop a reserve policy?

- A systematic approach with five key, consecutive steps:



### Step 1: Stating the reasons for maintaining reserve

- Maintaining a reserve means holding back of financial resources which could be otherwise deployed for service provision and other purposes in current year
- A reserve policy explains to funders, grant-makers, donors and other stakeholders why a reserve needs to be maintained for, say, the following reasons:
  - ✓ income variation
  - ✓ emergency spending
  - ✓ income generation
  - ✓ future commitment
  - ✓ cash flow mismatch



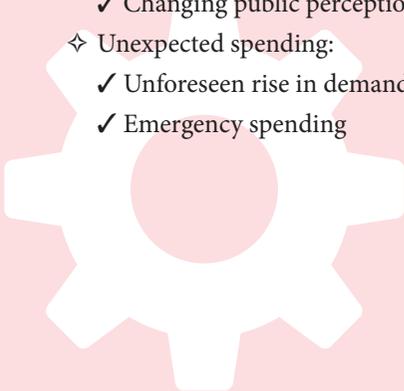
## Step 2: Reviewing income and expenditure pattern

- Reviewing the pattern of the NGO's income sources and assess their characteristics
  - ✧ Diversity of income source:
    - ✓ Single or dominant source
    - ✓ Multiple sources
  - ✧ Characteristics of each income source:
    - ✓ Vulnerability
    - ✓ Stability
    - ✓ Certainty
    - ✓ Predictability
- Reviewing the diversity of the NGO's expenditure items and assess their characteristics
  - ✧ Diversity of expenditure items:
    - ✓ Dominance of a particular expenditure item (e.g. staff costs, and rent, etc.)
  - ✧ Characteristics of each expenditure item:
    - ✓ Predictability
    - ✓ Stability



## Step 3: Understanding and assessing the financial impact of risk

- Risk equals to uncertainty
- Risk management is essential for sound governance
- Certain risk events should have financial impact
  - ✧ Variation in existing income source:
    - ✓ Termination of existing funding sources
    - ✓ Decrease in existing funding sources
    - ✓ Changing public perception towards a particular social issue
  - ✧ Unexpected spending:
    - ✓ Unforeseen rise in demand for services
    - ✓ Emergency spending



#### Step 4: Determining the target reserve level

- There is no one-size-fits-all level of reserve that is appropriate for all NGOs
- The target level reserve depends on the results of the three preceding steps:
  - ✓ income pattern
  - ✓ expenditure pattern
  - ✓ financial impact of risks
  - ✓ future plans and commitments
- The target level of reserve can be expressed as:
  - ✓ an absolute figure/range (e.g. 5 million / 4 to 6 million)
  - ✓ a relative figure/range (e.g. 3 month of operating expenditure)
- Cash flow forecast is normally used to determine a target reserve level
- It is crucial to adopt a proper timeframe to perform the cash flow forecast (e.g. monthly, quarterly or yearly)
- It is advisable for NGOs to use more than one timeframe to perform cash flow forecast on:
  - ✓ short-term volatility problem (cash flow mismatch)
  - ✓ seasonal variation (major fundraising event in a particular month)
  - ✓ long-term structural problem (unsustainable salary increment policy)
- It is crucial to perform stress test on the normal cash flow forecast with:
  - ✓ base-case scenario
  - ✓ worst-case scenario (e.g. termination of major funding source)

#### Step 5: Communicating the reserve policy

- Communicating with staff can be made through:
  - ✓ release of reserve policy
  - ✓ disclosure of level of reserve held and explanation of why they are held
- Communicating with external parties:
  - ✓ inclusion of a statement about reserve policy and current reserve level in annual report or website

## Reserve policy and strategy planning

- A properly executed reserve policy helps:
  - ✓ demonstrate financial and service sustainability
  - ✓ forward service planning
  - ✓ indicate future funding needs
  - ✓ indicate the need for reviewing current strategy
- Reserve policy is linked to strategic planning because:
  - ✓ reserve policy helps justify the need for strategic planning
  - ✓ reserve policy proves the financial sustainability of a strategic plan



### Disclaimer:

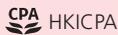
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### Hong Kong CPAs Making a Difference

The Hong Kong Institute of CPAs, the only statutory body for professional accountants in Hong Kong, takes its social responsibility seriously through mobilizing and empowering members to proactively and positively contribute to the development and well-being of the community with their professional skills, expertise and knowledge. “CPAs for NGOs” is one of the Institute’s core social responsibility projects. CPAs volunteer in various programme activities, including seminars, workshops and advisory sessions, to advise small- and medium-sized social service / non-governmental organizations on the best practices to strengthen their financial system and governance to achieve sustainable development.



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