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"CPA for NGO"
social responsibility programme
Reserve and financial sustainability



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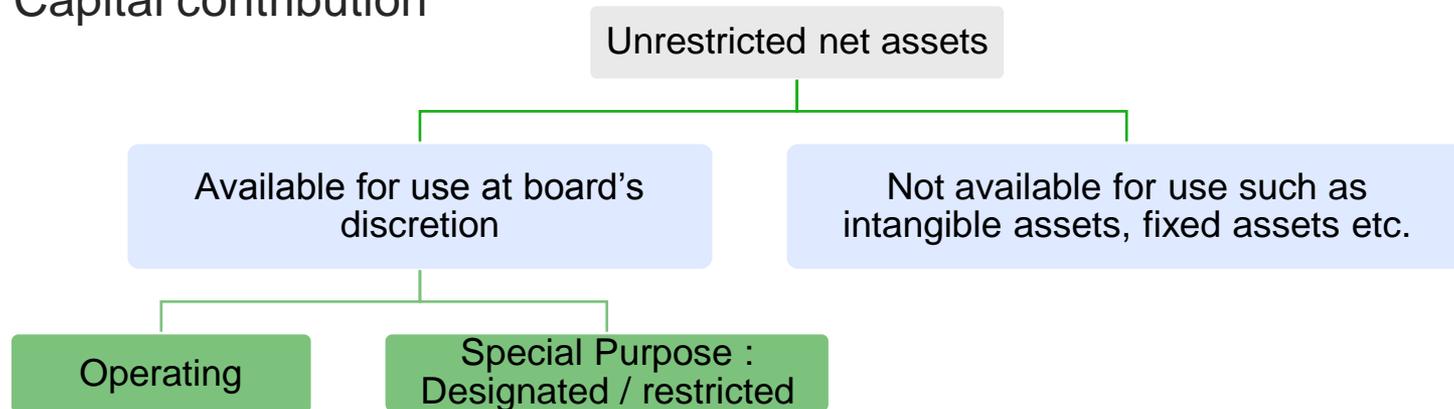
1. Introduction to Reserve



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What is Reserve?

- Unrestricted net assets that are available for use at the discretion of an organization's board. Accumulated from
 - Unspent income
 - Capital contribution

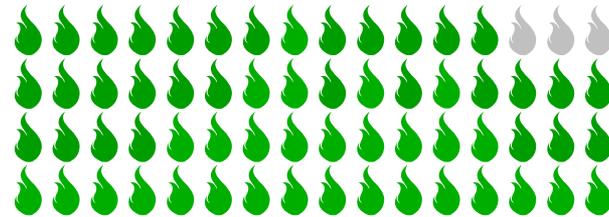


- Typical types of reserve for NGOs :
 - Lump Sum Grant (“LSG”) Reserve – support operating expenditure
 - LSG Provident Fund (“PF”) Reserve – Provident fund contributions
 - LSG Holding Account – balances exceeding designated level of LSG Reserve
 - General – for general operating expenses
 - Designated / restricted – limits for special nature / purpose of usage



Why Reserve Matters?

- Acts as a safety net for organizations to remain resilient and sustainable in upcoming risks
- Enhances financial flexibility for strategic initiatives
- Uses as internal financing for organization development
- Provides protection for service recipients



Reserve

Save for the rainy days

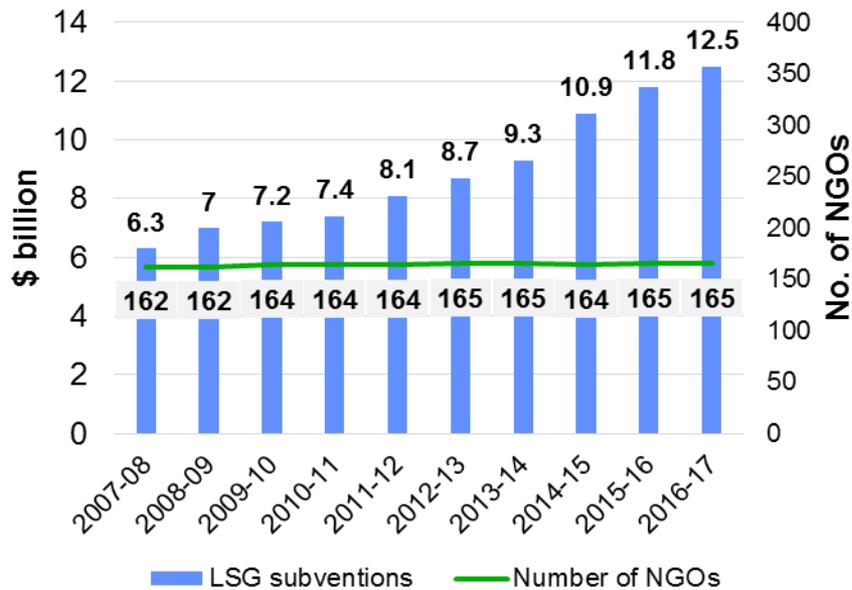


Overview of NGO LSG Reserve figures

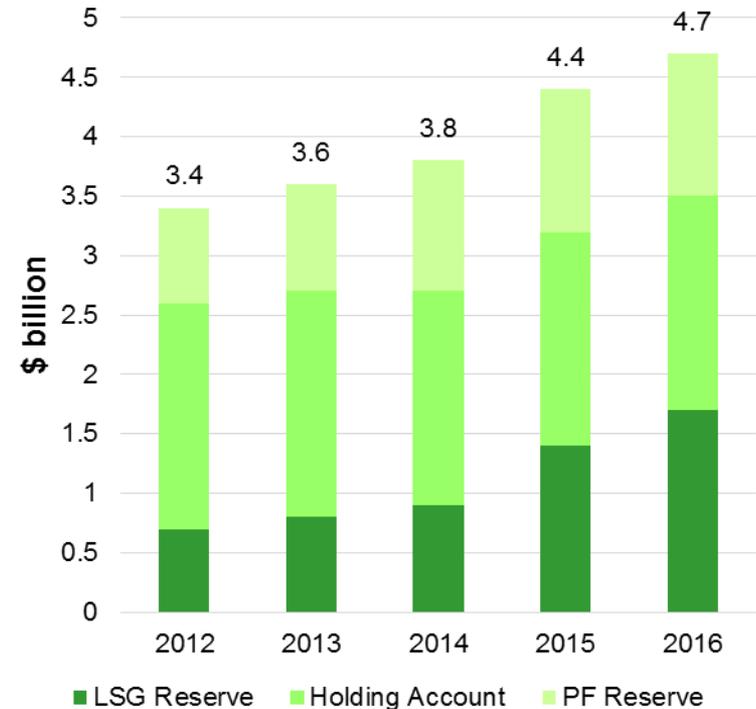
Key sources of Income

- Government
- Donation and grants
- Self financing activities

**LSG subvention
(2007-08 to 2016-17)**



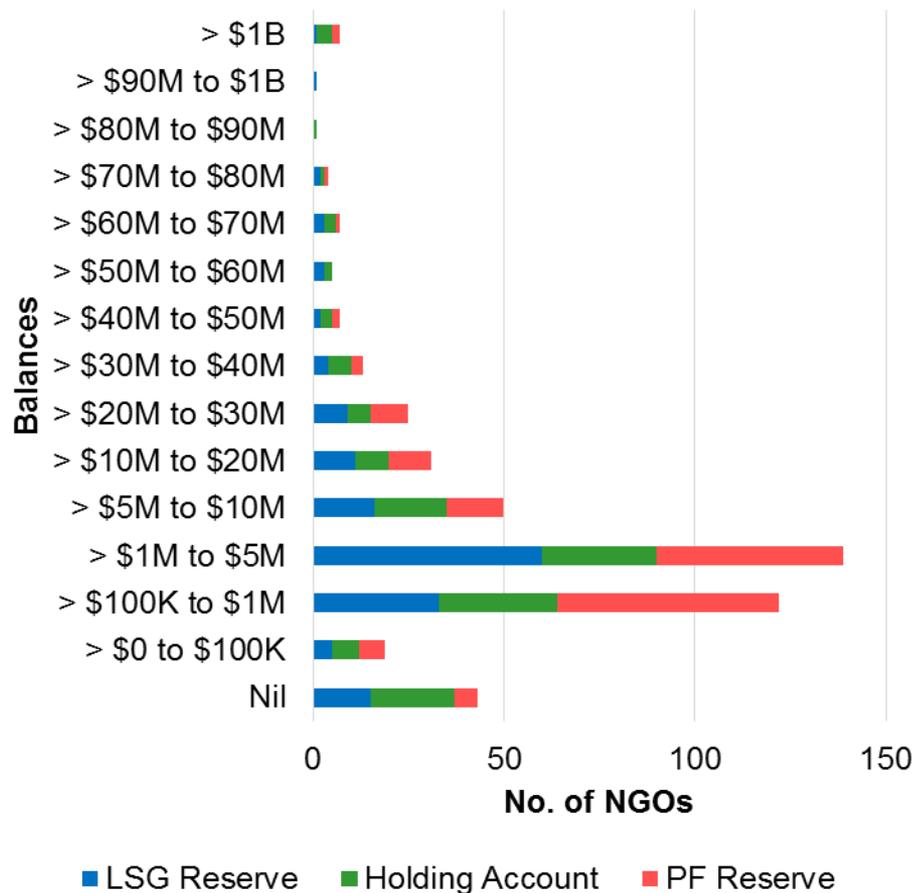
**Reserve retained by NGOs as of 31
March 2016
(2011-12 to 2015-16)**



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Overview of NGO LSG Reserve figures (Cont'd)

Balances of reserves retained by NGOs as of 31 March 2016



- Total number of NGOs retained LSG Reserve, Holding Account and PF Reserve as of 31 March 2016 are 165, 144 and 165 respectively
- The largest balance of NGOs' LSG Reserves was \$180 million
- The largest balance kept in NGO's Holding Accounts was \$170 million
- The largest balance of NGO's PF Reserves was \$112 million



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Sources of Non-LSG Funding

- Government: Various schemes and funding sources from Social Welfare Department, Education Bureau, Home Affairs Bureau, etc. – establishment/ recurring / project-based

- The Community Chest
 - 2017/18 allocated a total of HK\$298 million (161 member social welfare agencies) on services of children and youth, elderly, family and child welfare, medical and health, rehabilitation and aftercare etc.
 - Monitoring requirements:
 - a) Progress reports, bi-annual reports, annual reports, annual audited accounts and management letters

- Hong Kong Jockey Club Charities Trust
 - 2016/17 donated a total of HK\$4,100 million to 215 charitable and community projects. Serves 10 principal areas of civic and social needs in its contributions such as youth development, elderly, education training, sports and recreation etc.
 - Monitoring requirements:
 - a) Annual accounts as requested by the Hong Kong Jockey Club



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Source: <https://www.commchest.org/en/projects/current-year-allocation>
<http://charities.hkjc.com/charities/english/charities-trust/index.aspx>

2. Regulatory Framework for NGOs



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Lump Sum Grant Manual (For Agencies Receiving LSG)

- The Lump Sum Grant (“LSG”) Manual issued by SWD provides guidance for NGOs to enhance accountability, efficiency and cost-effectiveness in the use of public funds.
- It sets out :
 - a) the structure of LSG, Provident Fund provision and other related matters;
 - b) the financial management under LSG;
 - c) the respective roles and responsibilities and accountability of SWD and NGOs for the use of public funds; and
 - d) advice on best management practices and processes.



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Lump Sum Grant Manual (Cont'd)

(For Agencies Receiving LSG)

Financial management

2.32 - Reserves

- The level of cumulative reserves at the financial year end will be capped at 25% of the NGO's operating expenditure for that year
- Any exceeding amount needs to be refunded to the Government in the following financial year, unless upon application with justification from the NGO

2.33 to 2.36 - Investments

- Other than bank deposits, NGOs may consider investing surplus funds in their LSG Reserves based on the defined investment options
- NGO Boards/ Management Committees should, as part of their corporate governance, ensure that there are proper and effective internal procedures to control investments



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Best Practice Manual (For Agencies Receiving LSG)

- Recommended by the Lump Sum Grant Independent Review Committee, Best Practice Manual (“BPM”) for NGOs came into effect on 1 July 2014.
- Two main types of requirements:
 - a) Level One: expected to follow
 - b) Level Two: encouraged to adopt
- Annual review via self-assessment checklists in October each year

Areas	Level One	Level Two	Total
Financial Management	4	1	5
Human Resource Management	1	-	1
Corporate Governance and Accountability	2	6	8
Total	7	7	14



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Source: Lump Sum Grant Subvention System Best Practice Manual for Non-governmental Organizations (May 2014 edition)

Best Practice Manual (Cont'd)

Level one requirements

Financial management	
Area	Principle
1. Maximized Use of LSG Reserve	Fairly, reasonably, properly and effectively used with the implementation of strategic development plans
Measures: <ul style="list-style-type: none"> Based on the actual operations and development strategies to decide how the LSG reserve be utilized in different areas through regular discussions Establish policy and procedures of reserve usage and monitoring 	
2. Status of LSG Reserve	Disseminate information about the LSG reserve and future usage to staff members and the public
Measures: <ul style="list-style-type: none"> Dissemination channel should be convenient and user friendly. Communication should be timely with a brief plan on how the reserve will be used in the future 	
3. Use of PF Reserve	Maximize the use of PF reserve for non-snapshot staff
Measures: <ul style="list-style-type: none"> Regular monitoring of usage and link the reserve management to staffing strategies Special contribution should be assessed for effectiveness and approved before payment 	



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Source: Lump Sum Grant Subvention System Best Practice Manual for Non-governmental Organizations (May 2014 edition)

Best Practice Manual (Cont'd)

Level one requirements

Financial management

Area	Principle
4. Status of PF reserve	Disseminate information about the PF reserve to staff members, including a brief plan on future usage
Measures: <ul style="list-style-type: none">Dissemination channel should be convenient and user friendly. Communication should be timely with a brief plan on how the reserve will be used in the future	

Level two requirements

Financial management

Area	Principle
1. Optimal Level of Reserve	Based on sizes and actual needs, develop planning and evaluation mechanisms to determine the appropriate level and monitor it
Measures: <ul style="list-style-type: none">Establish mechanisms on planning, determining, monitoring and reporting of the level of reserve with regular revisit for organizational changes	



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Source: Lump Sum Grant Subvention System Best Practice Manual for Non-governmental Organizations (May 2014 edition)

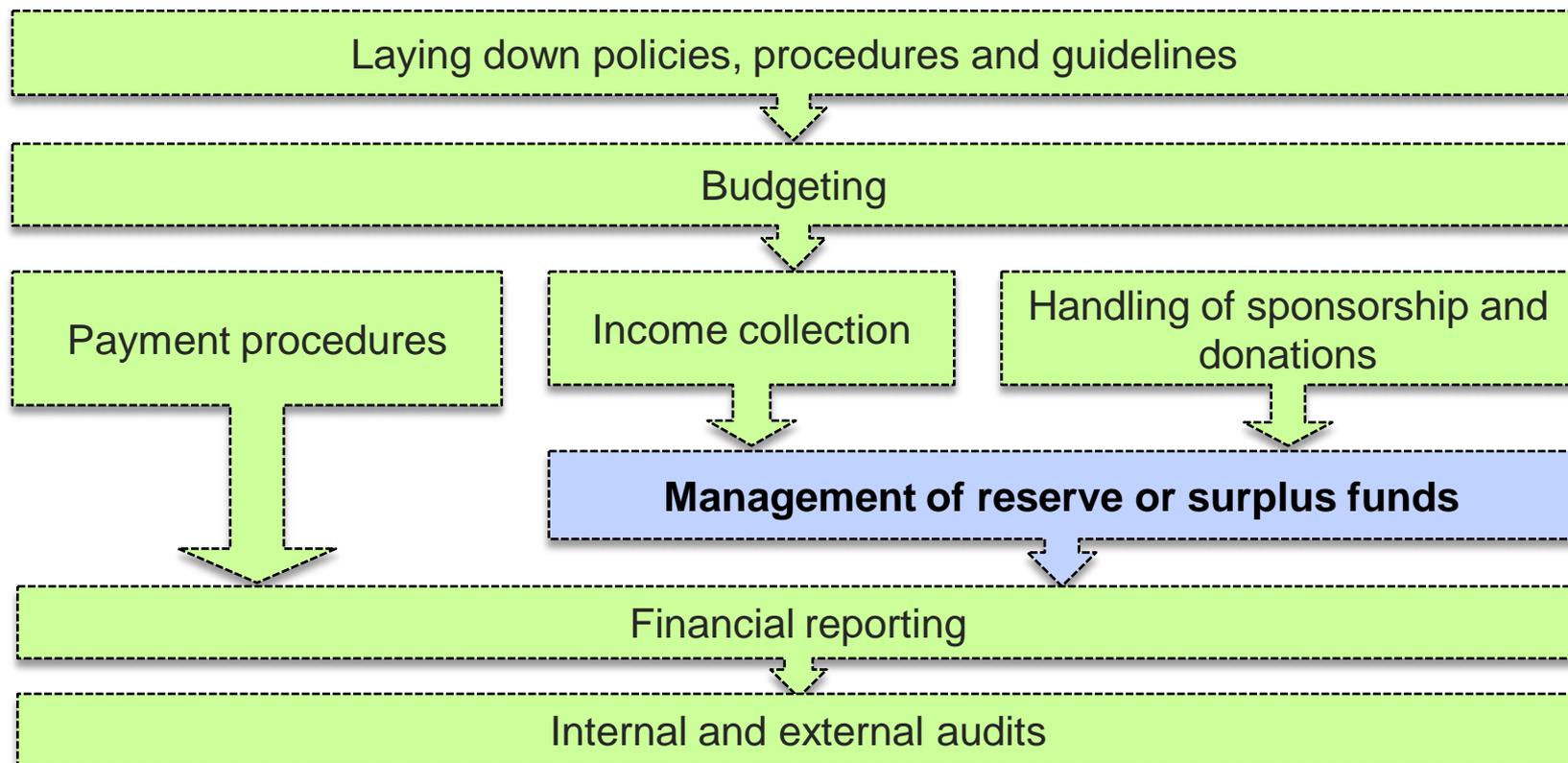
3. Reserve Policy



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Key Process in Financial Management

- Reserve management is one of the crucial element of sound financial management. While a robust financial management mechanism serves as a foundation for financial sustainability in the long run.



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
- Perquisite for utilizing reserve and the procedure
- Review mechanism

1

Managing 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)

2

A reserve policy for each category of reserve

- Lump sum grand reserve
- General fund reserve
- Designated fund reserve such as building and capital project reserve, education funds, programme reserves etc.

3



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Purpose of a Reserve Policy

- Income fund should be spent within a reasonable period of time upon receipt for the intended purposes
- A reserve policy sets the framework for maintaining an optimal level of reserve for service delivery, strategic plans implementation or as a buffer when NGOs' spend more than they can generate



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Key Elements of a Reserve Policy

- Statement of Purpose – The reason for establishing different reserves
- Policy – The objective to be achieved
- Definitions – Descriptions of the meaning of key terms used in the policy
- Procedures – Implementation details such as rules and methodology of setting reserve level and how reserves can be used which should be linked to investment and other financial management policy if necessary
- Monitoring – Procedures for approving the use of reserves, regular reporting, evaluation and accountability of reserve usage

Typical owner of reserve policy :
Finance / Treasury



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Reserve Planning Considerations

Budgeting

- What is your long term strategic and financial plan?
- A conservative versus an ambitious budget have significant variance of impact on reserve

Reserve Purpose

- How do you see your organization's reserve, for future operational development, or merely for filling up deficits?

Organization Specific

- Does your organization have to adopt the same reserve planning methodology as others?
- Each organization has its own operation model, relevant regulatory/donations requirements, business needs and risk profiles

Liquidity

- Does your organization sets adequate cash to fund daily operations, or appropriate level of discretionary fund for strategic priorities?
- Reserve is a only part of overall organization's liquidity



Reserve Management

Set regular monitoring and reporting measures, which should align with other financial management elements (such as budgeting, forecasting, investment etc.)

Stating the reasons for maintaining reserve and assign ownership of reserve management



Investment of Surplus Fund

Alternatives

- Interest bearing deposit
- Bonds
- Securities
- Funds
- Foreign currencies

Governance

- Allocation limit of different assets
- Pre-approval from Board on investment, appointment of fund manager and asset custodian
- Regular rebalancing of asset portfolio and reports for performance monitoring

Policy

- Objectives and strategies
- Designated investment options (short-term vs long-term; required credit rating)
- Monitoring and reporting (cash-flow projection and compliance check)
- Accounting treatment

Points to Note

- Risk appetite of individual organization
- Return on investment vs. liquidity
- Safeguard against management over-ride (bank signatories)
- Timeliness of post investment review



Reserve Policy Versus Reserves Planning

Group discussion:

- Is a reserve policy already in place at your organization?
- What topics have the policy covered?
- How is the reserve policy implemented?
- Does a reserve policy itself sufficient for your organization to cope with operational challenges?



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Break / Questions



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4. Commonly Observed Deficiencies

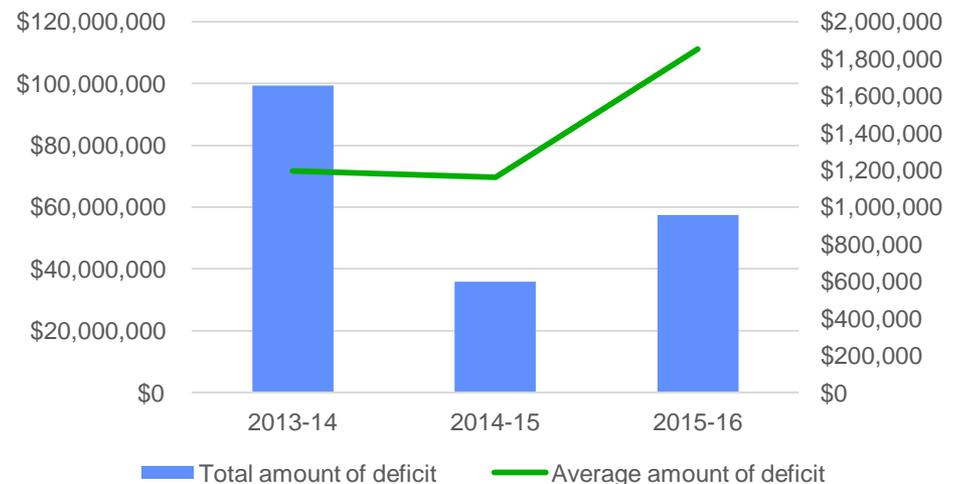


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Commonly Observed Deficiencies

- Usage of reserves is not maximized in order to support strategic development plans and / or facilitate realization of operational goals
- Operating deficits are noted for consecutive financial years
- Lack of budget planning and adequate subsequent monitoring of budget usage leading to untimely detection of operational fund drain
- Target reserve level has yet to take account into the risk profile of the organization or future organizational changes
- Reserve policy is not adopted / timely reviewed responding to operational needs

LSG deficits of NGOs



Case Study

NGO - A

- Having operational **deficit** for over the last 3 years
- Major income sources are from grants from other funding bodies and self financing activities
- Discontinued several of its servicing branches for cost control purposes

NGO - B

- Having operational **surplus** for over the last 3 years
- Major income sources are from government and grants from other funding bodies
- Reserve has reached a record high

1. If there is a surplus or deficit, do you know where it is coming from?
2. Has financial sustainability been established as a organizational goal?
3. If your organization were NGO A or B, what actions would you take in interim and long terms?



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5. Sharing on Good Practice



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Sharing on Good Practice

- Establish a sound budgeting process and regularly monitor budget usage against actual financial figures. A budget may be defined as a plan expressed in monetary term. It indicates the projected level of resources to be consumed to achieve planned activities over a specific period of time in the future
- Incorporate reserve element in budgeting process
- Set budget for different level: organizational, unit / department / branch, programme level and assigns budget holders
- Categorize reserve type and set limitations on relevant usage. Such as virement from reserve into entertainment / visits / travels to increase its budgeted amount is prohibited
- Define amount threshold / nature of expenses that have to go through budget check before validation and payment
- Establish an investment policy (with proper approval and monitoring) while taking into account the sponsoring / regulatory bodies' requirements



Case Illustration

An established NGO:

Financial Management

1. With financial policies and procedures covering income collection and expenditure management
2. Established budgeting framework, regular financial planning and reporting
3. Clear accountability and governance structure

Reserves Management

1. General reserve can be used for nearly all expenses under except for the specific restricted nature of expenditure
2. Regular reporting and monitoring of available fund
3. Virement from the “General Expenses” to “Senior Staff”, “Sub-ordinate Staff” and “Equipment” is not allowed without approval
4. Reserve can be used for staff employment is capped at a designated %
5. Budget holders are accountable for any violation of virement rules and reserve misuse

Income and Expenditure Management

1. Regular financial reports on donations are prepared by Finance and submitted to the Donation Committee with projected and actual figures
2. With “commitment” concept, budget is first held for future expenses based on PO/PR/contracts
3. Budget checks are established before payment
4. Approval level is set up for varied nature of expenses authorization before payment
5. Management reports at both organizational and unit level



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Tying It All Together

Regulatory Framework

- LSG Best Practice Manual
- Donors / sponsors' specific requirements

Reserve Policy

- Purpose and accountability
- Reviewing income and expenditure pattern
- Assess risks and plan ahead
- Set target level
- Monitor and report

Common Deficiencies

- Stacked up reserves
- Operating deficits
- Lack of budget planning and monitoring
- Risk profile not incorporated

Good Practice

- Sound budgeting process with reserve element
- Designate usage and restrict usage on sensitive expenditure
- Invest with proper controls



Q&A



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