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Date: **18 November 2015**

Envisoning Programme on the Best Practice Manual

Financial Management Lump Sum Grant, Reserve Fund, Financial Projection & Internal Controls



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OUTLINE

1. Fundamentals of Accounting Principles
2. Lump Sum Grant and Reserve Fund
3. Process of Financial Projection
4. Implementation of Internal Controls

PART 1

Fundamentals of Accounting Principles



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Accounting Principles

1. Going concern
2. Consistency
3. Prudence
4. Accrual basis

PART 2

What are Lump Sum Grant and Reserve Fund?

What is Lump Sum Grant?

- LSG is a social welfare subvention system through which the Government provides subvention to agencies for providing social welfare services.
- Under the LSG system, the Government provides subvention to agencies in the form of an agency-based lump sum grant; and agencies may **freely deploy the grant as long as the required objectives, outputs, results and standards of social welfare services provided are met.**
- In other words, this subvention model focuses on output control.
- The policy intends to encourage:
 - ✓ **Effective use of public resources**
 - ✓ **Innovation**
 - ✓ **Responsiveness**
 - ✓ **Performance management**



What is Lump Sum Grant?

- This social welfare subvention model requires agency heads to perform as a social entrepreneur:
 - ✓ Market-driven management style
 - ✓ Proactive human resources management (e.g. staffing and pay structure, manpower deployment, and etc.)
 - ✓ Active financial management practice
 - ✓ Proactive fund-raising effort
 - ✓ Service re-engineering and innovation
 - ✓ Corporate governance and transparency

- Among the above elements of social entrepreneurialism, agency heads are required to be financially-minded:
 - ✓ **Financial projection**
 - ✓ **Cost control**
 - ✓ **Investment/procurement decision-making**



What is Reserve Fund?

Lump Sum Grant Reserve

➤ LSG Reserve is generated from underspending of LSG provided by the Government against actual spending in providing subvented services (including personal emolument and other charges).

Provident Fund Reserve

➤ PFR is generated from the excess of the provident fund subvention provided by the Government (calculated at 6.8% of the mid-point salary of the recognized staff rank) over the actual provident fund expense for non-snapshot staff.



Reserve funds are utilized for:

1. Maintaining service delivery
2. Implementing strategic development plans
3. Building up staff team with high quality
4. Supporting professional development of staff
5. fulfilling the contractual commitment to staff
6. Contingency circumstances

Reserve Funds

ARE NOT SAVINGS DEPOSITS



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The Regulatory Framework for Reserve Fund

General principles

✓“When a NGO considers using its reserves, it must:-

(a)ensure that it will not encounter financial difficulties;

(b)if the NGO subsequently encounters financial difficulties, resolve the problem(s) on its own without any financial assistance from the Government;

(c)ensure that the problem(s) and resolution(s) do not have adverse effects on the NGO achieving the requirements of FSAs and the interests of its service users; and

(d)take into account their snapshot staff commitments, as well as the need for service enhancement and staff development.”

(para. 2.40 of LSG Manual)

The Regulatory Framework for Reserve Fund

General principles:

✓ NGOs Board/Management Committee should consider measures to optimally use the PF surplus from the 6.8% posts on staff who are not protected under the snapshot arrangement.

(para. 2.25 of LSG Manual)

✓ NGOs should fully deploy the PF provisions and reserves for non-snapshot staff on PF contributions, including possibly special contributions to award non-Snapshot Staff for their good performance.

(para. 2.26 of LSG Manual)



PART 3

Process of Financial Projection



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Planning your vacation



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Process of Financial Projection

Step 1: Preliminaries

Step 1a: Define the objectives

Step 1b: Collect data and information

Step 1c: Communicate with internal parties

Step 2: Expense Projection

Step 2a: Personal Emolument

Step 2b: Provident Fund

Step 2c: Other Charges



Process of Financial Projection

Step 3: Income Projection

Step 3a: Lump Sum Grant

Step 3b: Other income

Step 4: Consolidation

Step 4a: Prepare financial projection statement

Step 4b: Prepare reserve fund movement statement

Step 5: Making Managerial Decision

Step 5a: Determine necessary managerial actions

Step 5b: Assess the possible outcomes

Step 1a: Define the Objectives

- Financial projection is not ceremonial.
- The objectives of financial projection vary from agency to agency:
 - ✓ Exercising management stewardship
 - ✓ Determining the need for utilizing reserve funds
 - ✓ Determining the sustainability of reserve funds utilization
 - ✓ Determining fundraising requirements
 - ✓ Monitoring the use of financial resources
 - ✓ Planning for efficient use of financial resources
 - ✓ Planning for service enhancement, expansion or contraction
 - ✓ Fulfilling legal and regulatory requirements
- The objectives should be well-documented because:
 - ✓ Agencies are accountable to a wide audience.
 - ✓ Agencies are expected to be transparent.
 - ✓ Agencies are expected to use resources effectively and efficiently.

Step 1c: Communicate with Internal Parties

- Financial projection is not only the task of accounting team
- Instead, it is a top-level managerial activity which should be:
 - ✓ Led by top management
 - ✓ Participated by service heads and administration head
 - ✓ Executed by accounting department
- Because financial projection is a process involving:
 - ✓ Provision of up-to-date data and information from service sections
 - ✓ Assessment of the financial viability of service innovation
 - ✓ Determination of resource allocation
 - ✓ Identification of opportunity for service enhancement or expansion
 - ✓ Determination of resource re-allocation or service contraction
- It also provides a platform for internal communication

Step 2a & 2b: Personal Emoluments and Provident Fund

- Projections for personal emolument and provident fund should be rather straightforward.

- Data and information needed:
 - ✓ Staff strength (number of staff) as at the latest financial year-end date (e.g. 31 March 2014)
 - ✓ Salary level of each staff and planned pay rise/reduction
 - ✓ Planned number of new recruit and budgeted salary level
 - ✓ Planned number of staff under non-renewable contract
 - ✓ Planned number of retired staff
 - ✓ Estimated staff turnover
 - ✓ Contribution level of staff provident fund scheme



Step 2c: Other Charges

- We need to identify controlling factors affecting each of these other charge items.
 - Utilities: operation level and area of premises
 - Cleaning charges: area of premises
 - Postage: operation level
 - Phone and telecommunication: operation level and headcount
 - Advertisement: number and type of advertisement
 - Audit fee: audit scope and operation scale
 - Repair and maintenance: regular and one-off repair and maintenance
 - Printing and stationery: operation level and staff number
 - Transportation and travelling: operation level
 - Insurance: standard and non-routine insurance policy



Step 4a: Prepare Financial Projection Statement

	<u>2014/15</u>	<u>2015/16</u>	<u>2016/17</u>	<u>2017/18</u>	<u>2018/19</u>
<u>INCOME</u>					
Lump Sum Grant	\$12,000,000	\$12,480,000	\$12,854,400	\$13,240,032	\$13,769,633
Other income	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
	\$12,010,000	\$12,490,000	\$12,864,400	\$13,250,032	\$13,779,633
<u>EXPENDITURE</u>					
Personal Emolument	(\$11,200,000)	(\$11,704,000)	(\$12,289,200)	(\$12,780,768)	(\$13,164,191)
Other Charges	(\$2,800,000)	(\$2,940,000)	(\$3,087,000)	(\$3,241,350)	(\$3,403,400)
Surplus / (Deficit)	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
	(\$1,990,000)	(\$2,154,000)	(\$2,511,800)	(\$2,772,086)	(\$2,787,958)



Step 4b: Prepare Reserve Fund Movement Statement

	<u>2014/15</u>	<u>2015/16</u>	<u>2016/17</u>	<u>2017/18</u>	<u>2018/19</u>
Surplus / (Deficit)	(\$1,990,000)	(\$2,154,000)	(\$2,511,800)	(\$2,772,086)	(\$2,787,958)
<u>Reserve Utilization</u>					
LSG Reserve b/f.	\$5,500,000	\$3,510,000	\$1,356,000	(\$1,155,800)	(\$3,927,886)
LSG Reserve c/f	\$3,510,000	\$1,356,000	(\$1,155,800)	(\$3,927,886)	(\$6,715,844)



Step 4b: Prepare Reserve Fund Movement Statement

	<u>2014/15</u>	<u>2015/16</u>	<u>2016/17</u>	<u>2017/18</u>	<u>2018/19</u>
Subvention Received	\$235,000	\$244,400	\$254,176	\$264,343	\$274,920
Provident Fund Contribution Paid during the year	\$172,800	\$185,000	\$189,000	\$195,000	\$230,000
Surplus/(Deficit) for the Year	\$62,200	\$59,400	\$65,176	\$69,343	\$44,920
Add: Surplus/(Deficit) b/f.	\$500,000	\$562,200	\$621,600	\$686,776	\$756,119
Surplus/(Deficit) c/f.	\$562,200	\$621,600	\$686,776	\$756,119	\$801,039



Final Step

- ✓ As mentioned at the outset, financial projection is not ceremonial. Instead, it serves a set of pre-determined, documented purposes:
 - Exercising management stewardship
 - Determining fundraising requirements
 - Monitoring the use of financial resources
 - Planning for efficient use of financial resources
 - Planning for service enhancement, expansion or contraction
 - Fulfilling legal and regulatory requirements

Final Step

- ✓ After completion by the accounting department, the financial projection needs to be discussed among top management, service heads, administer and accountant-in-charge; and the following matters need to be documented:
 - Decisions (with reasons and opposite views) made based on the financial projection
 - Matters to be drawn to the attention of management board or other governance bodies
- ✓ The financial projection together with all supporting documents should be well-documented.
- ✓ Before performance of the next round of financial projection, the existing financial projection may be revised if needs arise.

Part 4

Implementation of internal control



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IMPLEMENTATION OF INTERNAL CONTROL

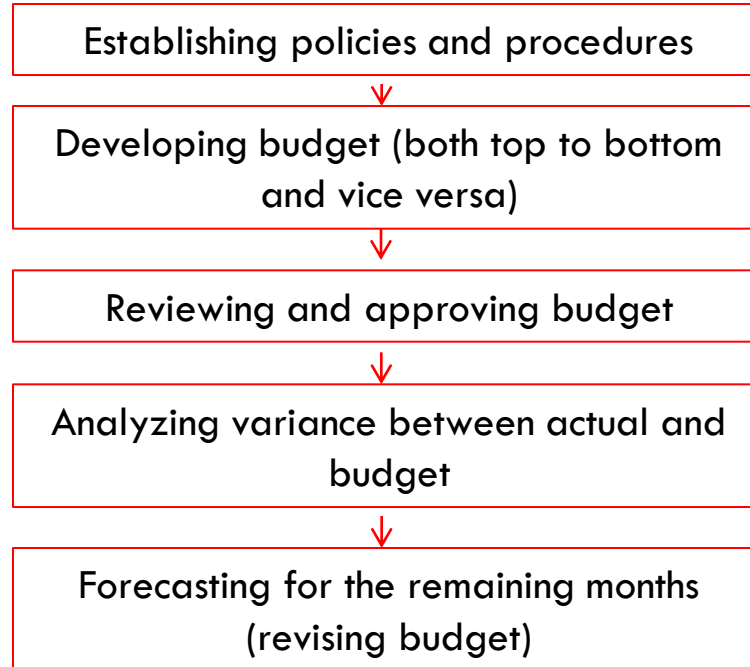
- Budgeting
- Procurement to payment (“P2P”)
- Cash management
- Financial close and reporting

Budgeting – Overview

Common risks

- Budget not aligned with business plan
- Unrealistic / unreliable budget for management to make business decisions
- Actual operation is not monitored against the original budget / plan

Key processes in budgeting



Budgeting – Common observations and principles / good practices at NGOs

Observations	Principles / Good practices
<ul style="list-style-type: none"> - Low levels of participation 	<ul style="list-style-type: none"> - Set up clear roles and responsibilities, announce / brief the responsible managers
<ul style="list-style-type: none"> - Budgetary slack - Underestimated the cost 	<ul style="list-style-type: none"> - Document the basis and assumptions of budget and retain source documents for review - Budget should be reviewed by two levels
<ul style="list-style-type: none"> - Variance is not timely followed up and reported 	<ul style="list-style-type: none"> - Establish the review and follow up mechanism - Assign roles and responsibilities between head quarter and business units
<ul style="list-style-type: none"> - Incorrect variance analysis due to data of center and project is not separately recorded 	<ul style="list-style-type: none"> - Assign a budget / account code during purchase requisition which should be reviewed by relevant budget controller - The code should be used throughout the entire accounting record process



Budgeting – Tips in setting up policies and procedures (“P&P”)

Developing budget:

- Roles and responsibilities of different departments
- Main considerations and basis for estimating income and expenditure
- Standard format for reporting budget items and sub-items
- Timeframe (e.g. submission deadline)
- Preparation procedures, and approval matrix for endorsing the budgets and the subsequent changes after budget approval (e.g. virement / transfer of funds from one budget item to another) if needed

Monitoring budget:

- Generate management reports (e.g. a breakdown by budget items and by individual cost centres)
- Set up alarm system to draw the attention of budget controllers any significant variances, require budget controllers to account for variances
- A computerized information management system with the capacity of keeping track of the financial data can help
- Considering key performance indicators (“KPIs”)

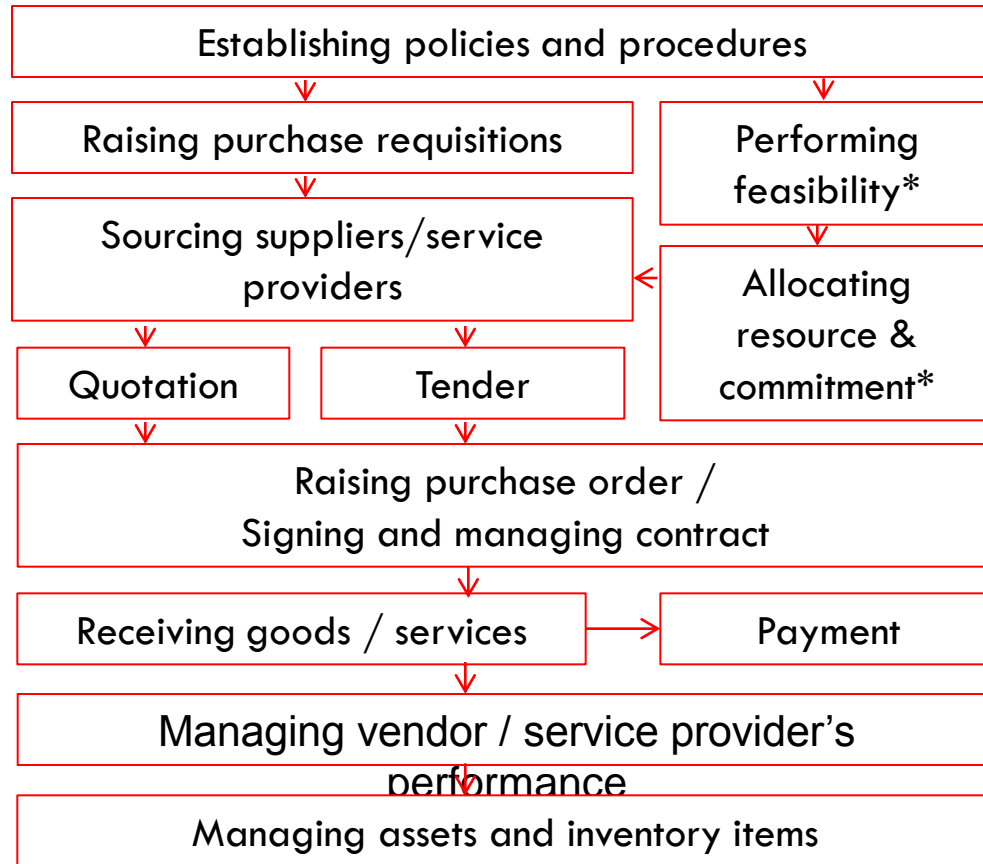


P2P– Overview

Common risks

- Engaged in non-feasible project / purchase of capital expenditure which cannot create long term values
- Favoritism in sourcing / selection of suppliers or service providers
- Acceptance at sub-standard goods / services or unfavorable price
- Payment made to invalid vendors
- Goods received are not consistent with purchase order
- Incorrect recording of disbursements and AP

Key processes in procurement



* For capital project/expenditure

P2P – Common observations and principles / good practices at NGOs

Observations	Principles / Good practices
<p>Sourcing vendor</p> <ul style="list-style-type: none"> - Inadequate approval authorities - Specific brand / sole supplier is selected without competitive bidding - Same supplier is selected for years 	<ul style="list-style-type: none"> - Assessment panel / board should be used for high value purchase - Document justification for specific brand / sole supplier of valuable assets for independent review - Review approved vendor list / bring in new vendors for selection - Obtain pricing info from the market periodically
<p>Quotation / Tender</p> <ul style="list-style-type: none"> - Awarded vendor does not provide the best overall value to the company 	<ul style="list-style-type: none"> - Vetting criteria should be pre-set with weighting of each assessment criterion - Request for price and technical submission in separate sealed envelopes



P2P – Common observations and principles / good practices at NGOs

Observations	Principles / Good practices
<p>Raising purchase order -Purchases same product frequently</p>	<ul style="list-style-type: none"> - Make it a rule for term contracts / bulk purchases for frequently purchased items
<p>Payment -Original invoice is not used -Approver approves his own payment request</p>	<ul style="list-style-type: none"> - Review original invoice and reject or obtain justification for the absence of original invoice - Approver's payment request should be approved by an independent person
<p>Vendor's performance -Vendor with poor performance is repeatedly engaged</p>	<ul style="list-style-type: none"> - Introduce performance evaluation mechanism - Suspend vendors with poor performance from future bidding for a specific period / Remove from approved vendor list as needed

P2P – Tips in setting up policies and procedures (“P&P”)

- Segregate duties as far as possible (separate sourcing / purchase / assessment / receipt)
- Specify the approving authorities and procurement methods for purchases of different values
- Higher level / counter-approval of authorities for sole source / unbudgeted item
- Including probity / anti-collusion clause in tender / quotation document
- Require tenderer to submit, together with their bids, a declaration pledging compliance with the anti-collusion clause



- The policies set should never less stringent than the requirements of the fund provider



Cash management – Points to consider



Common risks: Cash misappropriation

Observations	Principles / Good practices
<p>Cash receipt</p> <ul style="list-style-type: none">-A youth hostel overseas operates with receipt in non-cash channel, to minimize administrative works-Fraudulent activity was reported where the hostel manager took physical cash and granted access of vacant room to the payee-Revealed that controls to detect unauthorized access / stay was not in place	<ul style="list-style-type: none">- The overseeing body was recommended to conduct surprise check on vacant rooms to detect unauthorized access / stay

Cash management – Common observations and principles / good practices at NGOs

Observations	Principles / Good practices
<p>Petty cash / cash advance -Lack of segregation of duties between the role of cashier and accounting staff -No independent and ad hoc cash count</p>	<ul style="list-style-type: none"> - Separate custody of cash and account recording - Set time limit for claims of petty cash reimbursement / cash advance - Reimbursement only upon submission of original invoice or receipt; Claim form should be signed by the staff responsible and the supervisor - Independent and ad hoc cash count
<p>Corporate credit card -Director of Sales & Marketing used the corporate credit card to pay personal expense at HK\$200K during a six-month period. The balance is settled by the NGO through auto-payment</p>	<ul style="list-style-type: none"> - Auto-payment should be avoided - Prior to payment, itemized payment request form with original invoice should be prepared for the approval of the supervisor of the credit card holder and provided to Finance team for checking

Cash management – Common observations and principles / good practices at NGOs

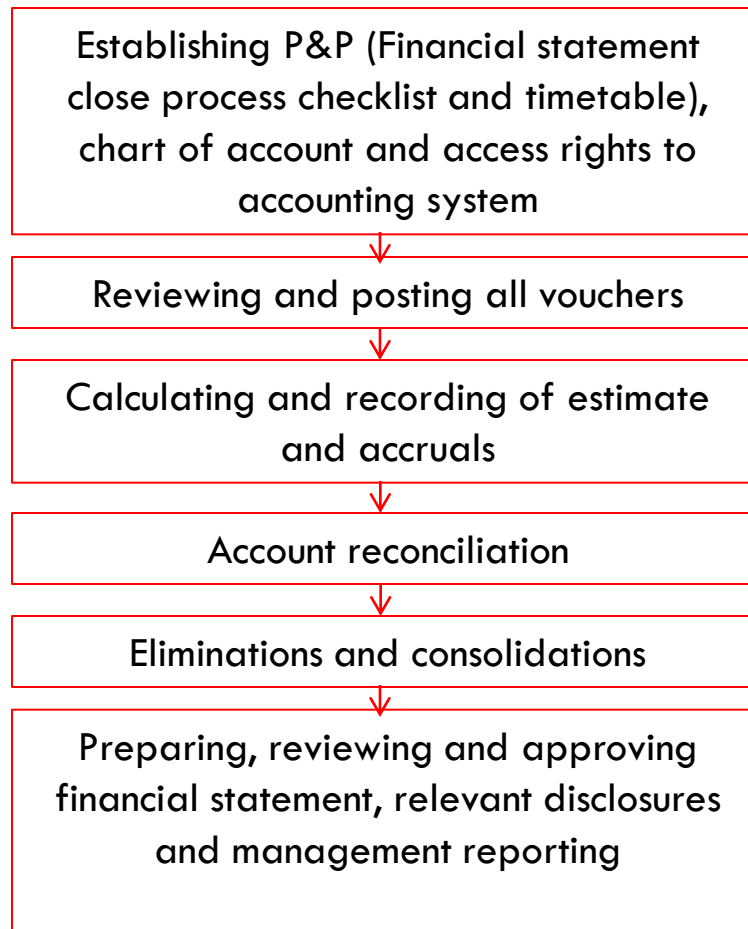
Observations	Principles / Good practices
<p>Online banking</p> <ul style="list-style-type: none"> -Board resolution did not cover online payment approval -“Unlimited” online payment authorization is granted to the Financial Controller (“FC”), which deviates from the Company’s authorization matrix (i.e. with limit set) -The FC was set up as the sole authorizer in the online banking platform. The FC provided the Finance Manager password and security token of the FC for payment approval 	<ul style="list-style-type: none"> - Board resolution, should include all payment types including online banking - Password and security token should not be shared to personnel who is not responsible for payment approval

Financial close and reporting – Overview

Common risks

- Incomplete / inaccurate financial information (data quality issue)
- Long cycle time leads to delay / ineffective periodic review by external auditors or management / board / audit committee
- Key performance indicators cannot fulfill the management's intention / reflect the result specifically for reporting purpose

Key processes in financial close



Financial close and reporting – Common observations and principles / good practices

Observations	Principles / Good practices
<ul style="list-style-type: none">- Financial statement close checklist is used, however, it is not well designed to reflect necessary information to facilitate the financial close process	<ul style="list-style-type: none">- Financial statement close checklist and timetable shall be designed to reflect the following:<ul style="list-style-type: none">- Clear roles and responsibilities of the involved parties- Close process at an activity level for daily monitoring- Dependencies between activities- Documentation required to support management control and review- Clarity of information / document flow- Company timelines



Financial close and reporting – Common observations and principles / good practices

Observations	Principles / Good practices
<ul style="list-style-type: none">- KPIs are overly generalized / simplified- Data input into the system is not specific to reflect business goals- For example: an elderly health care center wrongly set an KPI as the total number of individuals served. This KPI failed to account for different types of services (e.g. extensive care services vs blood pressure test) that the management intends to monitor	<ul style="list-style-type: none">- KPI should be set to fulfill at least the following principles:<ul style="list-style-type: none">- Result-oriented or Relevant- Specific- Measurable- Achievable- Time-bound



Financial close and reporting – Examples of KPIs for different NGOs

Education service

- Objective: Student success, quality academic and support services, adequate research funding and facilities etc.
- No. of students registered
- Attendance rate
- No. of teaching hours
- Passing rate for test / exam (internal / public)
- Graduation rate
- Faculty-to-student ratio
- Research funding and grants awarded

Health care / Social recreation services

- Objective: Quality services to target customers, cost-effectiveness etc.
- No. of patient / participant served
- Average wait time for each patient / participant
- No. of events held
- Average cost per events held
- Patient / participant satisfaction
- Usage of facilities

Public housing

- Objective: Effective use of public housing resources, open and fair housing allocation, sustainable rent-setting model
- Occupancy / Vacant rate
- Rent income
- Rent arrears
- Processing time for each application
- Response time for query received
- Handling of waiting list for rental housing



External reporting

Auditors' report – common qualifications

Proper communications with auditors and stakeholders

Thank You



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