

GOVERNANCE IN ACTION

Reserve of NGOs – Building Financial Resilience for Sustainability

Lately there are public concerns on whether NGOs should keep reserve and what level of reserve should be maintained. In the Governance Forum organized by HKCSS in November 2018, accounting professionals shared their views on various issues related to NGO reserve. The discussions in the Forum were organized and presented here to enhance the public's understanding of the subject matter and to provide a reference for NGOs in managing reserve and formulating related policies.

What is reserve?

In accounting practice, reserve is the asset after liabilities deducted. It is the resource that an organization accumulated and can be set aside for a particular purpose, e.g. renovation of premises. Reserve is a separate item shown in the balance sheet. When “reserve” was discussed in the Forum, the focus was on the “Survey on Financial Reserves of Social Service Agencies” jointly conducted by Deloitte China and HKCSS, and the information collected on Lump Sum Grant (LSG) reserve and general & non-designated reserve.

As stated in the “Quick Guide on Reserve Policy” published by the Hong Kong Institute of Certified Public Accountants (HKICPA), reserve can be used for emergency spending and future commitment.¹ Reserve allows organizations to meet unexpected needs without affecting the current and planned services. For instance, when donation approved is not released as scheduled, in responding to new service demand or paying non-budgeted expenses, organizations have to make use of reserve to cope with these situations. Reserve is also the cornerstone supporting long term development, providing resources for formulating strategic plan, ensuring sustainable and quality services for the clients.²

Level of reserve

Given the importance of reserve to daily operation and long term development, how much reserve should NGOs maintain? There is no definite answer. Each agency has its unique mission, background, scale, services, income sources and distribution. The level of reserve to be maintained is subject to the operational needs of each agency.

Ms Melissa Fung, Partner, Risk Advisory of Deloitte China, shared the implications from the findings of the Survey.³ A total of 100 agency members of the HKCSS responded to the Survey questionnaire, including both recipients of LSG from Social Welfare Department (SWD) and those which are not. On average, the agencies' LSG reserve can support related expenditure for three months. This indicates that agencies are compliant with the requirement on the maximum level of cumulative reserve at the financial year end stipulated in SWD's LSG Manual. Regarding the non-designated reserve, on average it can support agencies' related expenditure for 11.2 months, while the duration is 7.7 months and 12.7 months respectively for agencies with and without recurrent funding support. Ms Fung stated that this shows agencies without stable income from recurrent funding usually maintain a higher level of reserve to ensure continuity of services. Information from USA, UK and Australia also reveal that the reserve maintained by NGOs there are sufficient for 8 to 15 months' operation.



Plenary Session of NGO Governance Forum 2018: Reserve for Stability & Sustainability

¹ *CPA for NGOs Quick Guide Series: Reserve Policy*. Hong Kong Institute of Certified Public Accountants. Source: <https://governance.hkcss.org.hk/node/72>

² *Reserves and financial sustainability* (November 2018), Hong Kong Institute of Public Certified Accountants. Source: <https://governance.hkcss.org.hk/node/243>

³ *Insights from the Survey on Financial Reserves of Social Service Agencies* (November 2018), Ms Melissa Fung, Partner, Risk Advisory, Deloitte China. Source: <https://governance.hkcss.org.hk/node/312>

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Planning and monitoring of reserve

Agencies need to plan and monitor the use of reserve prudently in order to make reserve performs its role effectively. Findings of the Survey show that 62% of the responding agencies have set up finance or investment committees to formulate reserve plan and decide on the use of reserve. Committee members come from accounting, financial and legal sectors, amongst which over 80% are accounting professionals.⁴ They provide knowledge and experience from different expertise to enable agencies plan and use their reserve prudently.

In the process of making decision on reserve management, the responding agencies on average went through a 3-tier mechanism which includes the management and the board.⁵ Such cautious procedure ensures proper check and balance, and is a good reference that worth adopting by our sector.

Ms Loretta Fong, Vice Chairman of the Finance and Administration Committee, Hong Kong Young Women's Christian Association, shared in the Forum their experience in reserve planning and management and the importance of reserve planning on agencies' sustainable development. She stated that the Finance and Administration Committee was set up under the Board, with members from independent professionals. The Committee regularly monitors and reviews the level and status of reserve to ensure they are effectively used.⁶

Reserve policy

Reserve policy plays a critical role in agencies' financial governance. It explains to the public and stakeholders the prudent financial management of agencies, provides a well-justified explanation on the level of reserve, and demonstrates the agencies' financial capacity to sustain their mission pursuit. According to the Survey findings, more than 60% of the responding agencies have or are formulating policy on reserve management and investment. It demonstrates that they are striving for higher accountability and transparency.⁷

Mr Richard Tse, Chairman of Community Services Working Group, HKICPA, reminded agencies that reserve policy should be formulated in light of the actual financial status, direction of strategic development and the level of risk appetite, and that polices should be reviewed in appropriate time interval and updated regularly. The "Quick Guide on Reserve Policy" published by HKICPA suggests key steps in formulating reserve policy: 1) Stating the reasons for maintaining reserve, 2) Reviewing income and expenditure pattern, 3) Understanding and assessing financial impact on risk, 4) Determining the target reserve level, and 5) Communicating the reserve policy.⁸ Mr Tse pointed out that disclosure of reserve policy could increase public confidence in the agencies, subsequently enhance their social and financial capital which is conducive to the organization's development.⁹

Concluding remarks

Prudent financial management by the board and the management is crucial to agencies' sustainable and healthy growth and for them to create social impact. Reserve is a critical element in ensuring financial resilience. An appropriate level allows agencies to meet operational needs, pay for unexpected spending, and formulate long-term strategic plan.

⁴ Ibid

⁵ Ibid

⁶ *Case sharing on setting reserves and investment policies* (November 2018), Ms Loretta Fong, Vice Chairman of Finance and Administration Committee, Hong Kong Young Women's Christian Association. Source: <https://governance.hkcss.org.hk/node/314>

⁷ *Insights from the Survey on Financial Reserves of Social Service Agencies* (November 2018), Ms Melissa Fung, Partner, Risk Advisory, Deloitte China. Source: <https://governance.hkcss.org.hk/node/312>

⁸ *CPA for NGOs Quick Guide Series: Reserve Policy*. Hong Kong Institute of Certified Public Accountants. Source: <https://governance.hkcss.org.hk/node/72>

⁹ *Responses to the Key Findings of the Survey on Financial Reserves of Social Service Agencies* (November 2018), Mr Richard Tse, Chairman of Community Services Working Group, Hong Kong Institute of Certified Public Accountants. Source: <https://governance.hkcss.org.hk/node/313>