

## CHAPTER 3

### FINANCIAL MANAGEMENT

3.1 This Chapter on Financial Management describes the financial accounting, and external auditing requirements expected from non-governmental organisations (NGOs).

### FINANCIAL ACCOUNTING

3.2 This section provides the basic requirements in respect of accounting, financial reporting and internal control. Compliance with these requirements is a pre-requisite for NGOs receiving Lump Sum Grant (LSG) and is necessary to support sound financial management.

#### Accounting

3.3 NGOs must ensure that proper books of account and other accounting records are kept for all transactions, separately identified into **Funding and Service Agreement (FSA) activities** and support services (including central administration and supervisory support), and **non-FSA activities**.

3.4 Accounting requirements in respect of FSA activities and support services are as follows :

- (a) the financial year is from 1 April to 31 March of the following year;
- (b) NGOs need to properly account for the receipt of LSG and other social welfare subventions and expenditure in their accounts and annual financial statements;
- (c) a **separate Operating Income and Expenditure Account** must be kept for **each subvented service unit**, i.e. all those units under FSAs which are funded by LSG, other social welfare subventions (such as Central Items and Rent and Rates, as reported in Note 8 to the Annual Financial Report (AFR)), and other income. The Operating Income and Expenditure Account for each subvented service unit must :
  - (i) be separated into FSA activities and non-FSA activities;

- (ii) use the **Chart of Accounts** described in **Annex 4** (as may be updated) in maintaining accounting records;
  - (iii) be the source of information for the NGO to produce the AFR described in **Annex 5**; and
  - (iv) be an integral part of the overall Audited Accounts of the NGO.
- (d) NGOs need to prepare the AFR for FSA activities and support services; and
- (e) income and expenditure for specific programme activity, which is financed by income receipt or designated donations, must be shown separately in the accounts.

3.5 The following basic **books of account and accounting records** must be kept by each NGO :

- (a) Books of Account and Records :
- (i) cash book;
  - (ii) daily collection summaries and revenue receipt counterfoils in respect of donations, subscriptions and fees etc.;
  - (iii) payment vouchers in respect of all types of expenditure;
  - (iv) paylists in respect of all personal emoluments expenditure;
  - (v) staff records such as appointment letters, documents relating to promotion, transfer, incremental date, etc.;
  - (vi) register of fixed assets;
  - (vii) ledgers showing accounts in respect of all income and expenditure, assets and liabilities; and
  - (viii) journal for all transfers and adjustments.
- (b) Books of account and other related records must be **retained for the minimum period** specified below :
- (i) records of a permanent nature e.g. annual financial statements, inventories, records of capital nature and government non-recurrent grants etc. shall not be destroyed without the prior approval of Director of Social Welfare;

- (ii) records which may be destroyed after a minimum retention period of 7 years include all books of account (e.g. ledgers, cash books etc.), vouchers, invoice/ claims, fee receipts and bank statements; and
  - (iii) records which may be destroyed after a minimum retention period of 2 years include duplicate documents, e.g. quarterly returns, quotation details, paysheets and vouchers.
- (c) Books of account and all other relevant records and information must, at all reasonable times, be available for inspection by authorised staff of the Social Welfare Department (SWD) and audit by the Audit Commission.

3.6 NGOs are also responsible for making improvements to their accounting systems in accordance with the advice of their auditors as set out in their management letter, and SWD.

### **Financial Reporting**

3.7 The basic financial reporting requirement is the submission of the **AFR** together with a review report thereon issued by the external auditors in respect of all FSA activities (including their support services to FSA activities), and the **audited financial statements of the NGO as a whole**.

3.8 An NGO must prepare an **AFR** in respect of all its FSA activities (including support services to FSA activities) funded by LSG, other social welfare subventions and other income. The required format of this Report is set out in **Annex 5** (as may be updated). The AFR must :

- (a) derive its content from and be reconcilable with the Operating Income and Expenditure Account of all the subvented service units under FSAs; and
- (b) show at NGO level, in respect of :
  - (i) Provident Fund (PF) subvention received and PF expenditure, the split between Snapshot Staff and 6.8% posts;
  - (ii) analysis on number of posts with annual personal emoluments over \$700,000 each paid under LSG; and
  - (iii) analysis of LSG Reserve and balances of other SWD

subventions.

3.9 Paragraph 5 of the Notes on the AFR in Appendix 6 to the LSG Manual (Edition 2) required all donations and income other than recognised social welfare fee income to be reflected as Other Income in AFR. In response to the comments received, as an improved arrangement, non-SWD subventions and donations received need not be included as Other Income in AFR. In this respect, donations should be included if it is used to finance expenditure reflected in the AFR. However, treatment of fees and charges as specified under paragraphs 2.28 to 2.29 remains unchanged.

3.10 For stewardship purposes and in line with Government accounts, AFR, which is a separate document required for the purpose of accounting to the funder (i.e. SWD) the proper use of subventions, should be prepared on cash accounting basis.

3.11 The AFR (**Annex 5**) must be an integral part of the NGO's Annual Report. If any NGO chooses not to provide the AFR in its Annual Report, it has to upload the **full set of the latest AFR onto its website and specify the website address linking to the AFR in its Annual Report**. For NGOs not publishing Annual Report, they have to follow paragraphs 4.14 and 4.15 in respect of public disclosure of the AFR.

## **FINANCIAL REPORTING REQUIREMENTS**

### **Reporting of Investment**

3.12 NGOs with positive LSG Reserve balance are required to attach to the AFR submitted to the Finance Branch of SWD a schedule showing a breakdown of investments at the financial year-end (**Annex 3**). The schedule should be certified by the Chairperson/ NGO Head/ Head of Social Welfare Services. In case there is a difference between the total amount of LSG Reserve and investments, this should be clearly explained by way of Notes to be attached to the schedule.

### **Reporting of Provident Fund**

3.13 It should be noted that PF received and contributed for staff under the Central Items should be separately included as part of the income and expenditure of the relevant items specified in paragraph 3 of the Notes on the AFR in **Annex 5**. In other words, such PF should not be included in paragraph 1c of these Notes.

### **Reporting of Central Items**

3.14 NGOs are required to submit an analysis of the Central Items at the subvented service unit level (**Annex 6**) together with their AFRs. This is required in view of the subvention principle that the surplus or deficit of each of the Central Items for each financial year should be separately ascertained and any surplus, which is not allowed to be offset by any deficit, will be subject to claw-back by SWD according to the terms and conditions of individual Central Items.

### **Reporting of Rent and Rates**

3.15 NGOs are required to submit an analysis of Rent and Rates at the subvented service unit level (**Annex 7**) together with their AFRs. This is required in view of the subvention principle that Rent and Rates are paid on actual basis and the surplus or deficit of each unit for each financial year should be separately ascertained and any surplus, which is not allowed to be offset by any deficit, will be refunded to SWD. Vice versa, NGOs may apply for supplementary provision to cover any deficit on these items if necessary.

### **Reporting of Special Items**

3.16 According to paragraph 2.16(a), Standalone Child Care Centres, which will continue to be subvented under current subvention rules and accounting arrangements, are not required to be included in the NGOs' AFR. Nevertheless, NGOs should follow the previous practice to report these items in their Accompanying Financial Statements and send them to SWD at the same time when the AFRs are submitted.

3.17 If special items or grants are allocated by SWD to NGOs as LSG subvention, these allocations should be reported in the AFR.

## **Reporting of Comparative Figures**

3.18 For the first financial year after joining the LSG, the comparative figures for the previous year in the AFR are not mandatory.

## **Streamlining of Financial Reporting Requirements**

3.19 Starting from 2008-09, submission of Note 9 to the AFR is no longer required. However, to achieve sound and prudent financial management, NGOs are expected to maintain separate accounting records for each subvented service unit as before. This will not only be useful for resources management purpose by NGOs, but will also contribute to their monitoring of service performance of individual service units. During subvention inspection to be carried out by SWD, NGOs are expected to produce income and expenditure statements in respect of each subvented service unit for review when required.

3.20 NGOs are advised to have annual financial budgeting at the beginning of each financial year. If they anticipate financial difficulty, their Board should have thorough deliberation and inform SWD in advance, so that remedial measures can be taken as appropriate before the NGOs exhaust their reserves.

3.21 SWD will study individual case situations and request the NGOs to provide further information for analysis if necessary. SWD will follow up with the NGOs on possible solutions.

3.22 On exceptional and justifiable circumstances, NGOs may apply to SWD for advancement of allocation of subvention on Other Charges. The advancement should normally be within the same financial year. In case of special request for cross-year advancement, approval from related authority has to be sought.

## **INTERNAL CONTROL**

3.23 Internal control is fundamental to sound and prudent financial management. NGOs should always ensure that adequate internal controls are in place having regard to the nature and size of their organisation and the services provided. Advice on internal control procedures in respect of important financial activities has been provided by SWD as part of the Subvention Inspection process and is set out in **Annex 8**.

## **PROCUREMENT**

3.24 NGOs are largely financed by public resources, whether through Government subventions or public donations. They should therefore be accountable to the public for the use of that money and should always be prepared to account for their purchasing decisions. Hence, NGOs are obliged to achieve the best value of money for their procurements.

3.25 To ensure transparency and open and fair competition, all requirements and specifications of the intended procurements should be clear and made known to all the possible suppliers and contractors. It is necessary to give a fair chance of competition as far as possible to all possible candidates to bid the contract. All tenderers and suppliers should be treated on equal footing. To assist NGOs in achieving the procurement policy as stated in paragraph 3.24 and in this paragraph, NGOs should consider adopting the procurement procedures in Section Nine of **Annex 8**, and draw up procurement guidelines of their own in line with those of the prevailing LF Manual.

3.26 In making use of LSG for procurement, NGOs should take into account their duty to safeguard national security and not to engage in any acts or activities which endanger national security. The management of NGOs should exercise professional judgment, sensitivity and prudence in assessing any potential national security risks or issues that may be involved in every stage of the procurement. The duty for NGOs to safeguard national security is a continuing one that subsists throughout every stage of the entire procurement process, including the pre-contract award stage and the contract management stage after contract award. Specific clauses to allow disqualification of tenderers and to terminate the contract in the interest of national security should be introduced in the contracts for procurement.

## **EXTERNAL AUDITING**

3.27 Each NGO should arrange its **AFR** to be reviewed by its external auditors. Such review should be conducted in accordance with the Practice Note 851 “Review of the Annual Financial Reports of Non-governmental Organisations” issued by the Hong Kong Institute of Certified Public Accountants. An example of the review report on the AFR is given at **Appendix II** to Practice Note 851.

3.28 The AFR should be reviewed and the annual financial statements of the NGO as a whole should be audited by a certified public accountant holding a practicing certificate as defined in the Professional Accountants Ordinance (Chapter 50) and signed by two authorised representatives of the NGO i.e. Chairperson/ NGO Head/ Head of Social Welfare Services.

3.29 An external auditors' management letter in respect of the audit of the annual financial statements of the NGO as a whole is also required to be prepared for submission to SWD. An external audit should involve a general appraisal of the adequacy and effectiveness of financial and accounting records and procedures aimed at providing proper and effective internal controls. The auditors may discover, during the course of the audit, weaknesses in the NGO's internal controls. These should be brought to the attention of the management together with recommendations for improvement in the auditors' management letter.

3.30 NGOs are required to **forward annually two copies of the AFR, together with the auditors' review report and audited financial statements of the NGO as a whole**, together with the auditors' management letter as described above to SWD **not later than 31 October** following the end of the financial year i.e. 31 March. Unless otherwise approved by SWD, NGOs must ensure that the due date for submission is strictly observed.

## **SUBVENTION INSPECTION**

3.31 SWD will conduct Subvention Inspection in respect of LSG. The inspection will include reviewing compliance with accounting and financial reporting requirements as laid down in the LSG Manual, and reviewing/ advising on internal control procedures. Performance auditing may also be conducted. It will include working with, for example, the SWD's Subventions Section in respect of value for money audits.