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HKCGI Public Governance Guidance Note (Tenth Issue): The need for transparency and accountability of financial disclosures

As part of our public guidance notes, we have considered a number of issues. We will in this guidance note identify operational issues affecting charities and non-profit organisations. We will then seek to increase understanding and offer some helpful advice on accounting and reporting issues. We will employ a series of questions and responses.

Questions and responses

What are some of the top operational issues affecting charities and non-profit organisations?

Financial responsibility: They should make sure that they efficiently handle their money and can account for every dollar they get and spend.

Good Governance: They should have effective management, strong governance frameworks, and transparent decision-making procedures as hallmarks of good governance.

Protection: They should offer a secure atmosphere for their volunteers and beneficiaries, and they should have the necessary policies and processes in place to defend against abuse and harm.

Fraud and other financial crimes: They should be vigilant to falling victim to money laundering or other types of financial crimes. Any and all reports of misconduct should be thoroughly investigated.

Public confidence and trust: They should uphold the public's confidence and trust, and refrain from acting in a way that would jeopardise it, such as through dishonesty, fraud, or other misbehaviour.

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Impact and effectiveness: They should work effectively and efficiently to accomplish their goals and have a beneficial impact on both their recipients and society at large.

A Hong Kong case where financial responsibility was called into question

It was discovered that a well-known humanitarian organisation, had misappropriated donations made for relief operations after the 2011 earthquake and tsunami in Japan, the organisation came under public scrutiny and criticism in 2015. Only HK$50 million (US$6.5 million) of the organisation's HK$101 million (US$13 million) in donations for disaster relief were used for the intended purpose, it was found.

A lack of openness and inadequate financial controls were blamed for the squandering of the cash. The organisation failed to disclose the specifics of its spending and improperly tracking how the contributed funds were used. It was criticised for paying its senior employees, including the CEO, excessive wages, which raised questions about the management's performance. The issue significantly harmed the organisation's reputation and reduced public confidence in the group. A number of changes were made by the organisation, including the creation of a new independent audit committee and the adoption of new standards for financial management and reporting.

The significance of sound financial management and openness for charities and non-profit organisations is brought home by this instance. It also emphasises the necessity of strong control and accountability systems to ensure that donations are used for their intended purposes and that the public's confidence is upheld.

Please elaborate more about financial responsibility.

To ensure that charities and not-for-profit organisations manage their finances efficiently, use their resources wisely, and are able to account for all the money they receive and spend, financial accountability is required. In recent years, some of the major challenges and instances of worry areas have been:

1. Financial mismanagement: Concerns have been raised concerning instances in which charities and not-for-profit organisations have misused their funds, including instances in which money was spent improperly or in which there was insufficient financial control or monitoring. For instance, a charity that had spent more than £1 million on "questionable" international programs was the subject of an investigation in the UK in 2020.

2. Financial crime and fraud: There have been instances where charities and not-for-profit organisations have fallen victim to money laundering or other types of financial crime. For instance, a charity that had been used to conceal the proceeds of a £100 million tax fraud operation was under investigation in the UK in 2018.

3. Fundraising techniques: Concerns have been raised regarding fundraising techniques that do not follow the law or moral guidelines. An illustration would be the use of pushy and deceptive fundraising strategies.

4. Reserves and financial sustainability: For financial sustainability over the long term, there should be adequate reserves. There are worries that the reliance of many charities and not-for-profit organisations on short-term reserves to fund their expenses could result in future financial instability.

Please share some policies and procedure, and suggested practices exist to address financial accountability?

The policies and procedures, and practices listed below are meant to assist charities and not-for-profit organisations in properly managing their funds and making sure they are accountable to their stakeholders:

Accounting and reporting: They must provide yearly financial statements and maintain proper accounting records.

Internal financial controls: They should have sufficient internal financial controls to ensure that monies are utilised for their intended purposes and that their finances are managed properly. A distinct division of responsibilities, frequent financial reporting and review, and suitable authorisation procedures are all necessary.

Reserves policy: To preserve financial stability and to manage risks, they should have a reserve policy that specifies how much money they should keep in reserve. When establishing their reserves policy, they will need to evaluate their financial risks and take into account elements like cash flow and funding sources.

Risk management: They are urged to have a framework in place for managing risks that includes adequate controls and mitigating actions.

External examination: They should annually have their financial accounts subjected to an independent examination or external audit.

What should the format be for a policy statement on accounting and reporting?

The precise policies and processes will change depending on the unique conditions and requirements of the charity or not-for-profit. The following is an example of a generic accounting and reporting policy. But this policy statement offers a solid place to start when creating your own accounting and reporting guidelines. There would be more needed to suit the purpose of your charity or not-for-profit organisation.

Purpose. This policy sets out our approach to accounting and reporting and aims to ensure that we maintain accurate financial records, produce timely and relevant financial statements, and comply with all legal and regulatory requirements.

Definitions. For the purposes of this policy, 'accounting records' refer to the records that we keep of our financial transactions, and 'financial statements' refer to the formal reports that summarise our financial position and performance.

Accounting Records. We will maintain accurate and complete accounting records that:

1. Record all financial transactions and events.
2. Show our financial position at any time.
3. Enable us to prepare timely and accurate financial statements.
4. Comply with all legal and regulatory requirements.

Financial Statements. We will prepare annual financial statements that:

1. Comply with all relevant accounting standards and applicable guidance.
2. Provide a true and fair view of the charity's financial position and performance.
3. Produced in a timely manner, in accordance with any legal or regulatory deadlines.
4. Audited or independently examined as required by law.

Compliance. We will comply with all legal and regulatory requirements relating to accounting and reporting, including:

1. Under all applicable guidance on accounting and reporting.
2. Any other relevant legislation.
3. Any legal or regulatory deadlines for filing financial statements.

Review. This policy will be reviewed annually, or as needed to ensure that it remains relevant and effective.

Good governance practices

To uphold transparency and accountability, charities and other not-for-profit organisations are required to disclose specific financial information to the public. Some typical financial disclosures for these organisations include the following:

1. Annual reports: The majority of charities and non-profits should consider to produce and publish an annual report that includes a summary of their vision and mission, core values, accomplishments, activities, and financial situation for the year.

2. Financial statements: Financial statements, such as balance sheets, income statements, and cash flow statements, offer comprehensive details about the financial position and performance of the organisation.

3. Audited financial statements: Charities and not-for-profit organisations might also be required to have an independent auditor audit their financial statements. The auditor's report ensures the accuracy and adherence to accounting standards of the financial statements.

4. Information about donors: Charities and not-for-profit organisations should also consider to make donor information public, including the names of significant donors and the total amount of contributions received.

5. Fundraising activities: Details about fundraising initiatives, including funds raised and outlays, may also be revealed.

The purpose of these financial disclosures is to inform stakeholders about the organisation's financial performance, operations, and resources. To keep the public's trust and credibility, charities and not-for-profit organisations should deliver accurate and timely financial information.

Regardless of the scope of disclosures, charities and not-for-profit organisations ought to make critical financial information public, including:

1. Cost to serve: This is the price of providing services to beneficiaries, including the price of labour, supplies, and other outlays.

2. The ratio of funds to administrative fees demonstrates the percentage of funds spent on overhead costs including salaries, rent, and other administrative costs.

3. Employee to beneficiaries' ratio: This ratio displays how many employees are employed in relation to the quantity of beneficiaries or clients served.

4. Expense breakdown: Charities and non-profit organisations should offer a thorough breakdown of their costs, detailing how much was allocated to various projects and activities.

5. Investment portfolio: If the organisation has investments, it should provide details about those investments, including the types of investments, the level of risk, and the return on investment.

6. Impact report: Charities and not-for-profit organisations are also permitted to publish an impact report that details how their initiatives have affected the communities they work with.

Charities and not-for-profit organisations can show

their dedication to accountability and transparency by sharing the facts, as well as giving stakeholders the knowledge they need to make wise decisions, and hence their support.

As charities and not-for-profit organisations are subject to the scrutiny of new laws and regulations such as those relating to data privacy, anti-money laundering, sustainability, and national security, we recommend that the board of directors and senior management allocate a reasonable budget to hiring a qualified workforce and providing them with appropriate training.