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# **"CPAs for NGOs" social responsibility programme**

## **Seminar on Financial Management and External Reporting**



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# Financial management

## Part 1 - Implementation of internal control

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

## Part 2 - Overview of internal audit function

- Objectives and scope, principles and values
- Types of internal audit
- Internal audit in a governance structure
- Internal audit cycle
- Limited survey on internal audit models
- Challenges / benefits overtime for NGOs with internal audit function



# External reporting

**Auditors' report – common qualifications**

**Proper communications with auditors and stakeholders**



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# Part 1 – Implementation of internal control



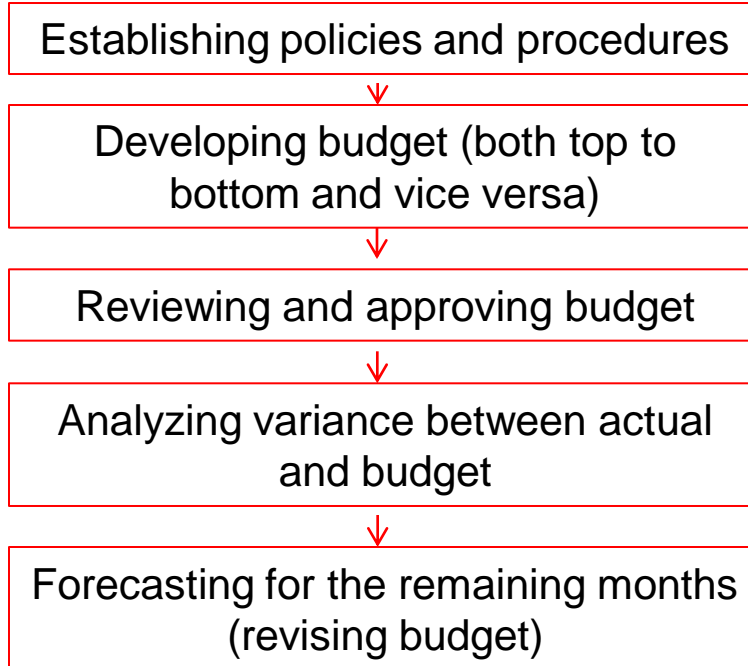
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# Budgeting – Overview

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



# 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:

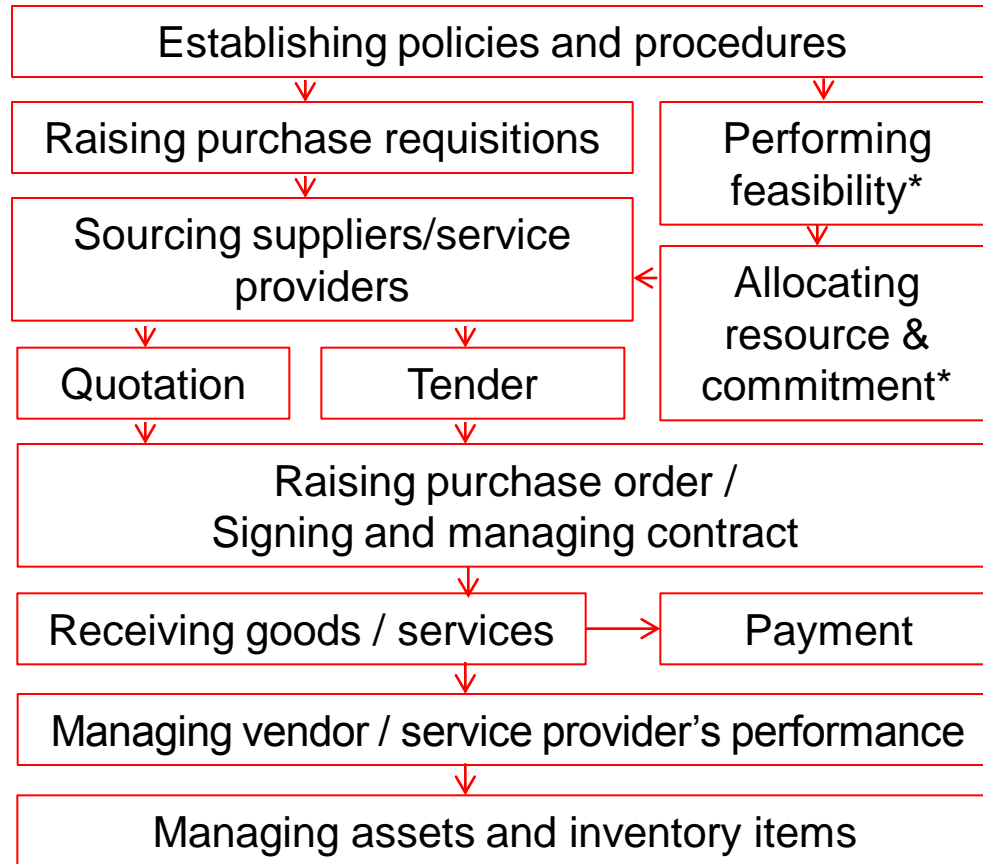
- Generate management reports (e.g. a breakdown by budget items and by individual cost centres)
- Set up alarm system to draw the attention of budget controllers any significant variances, require budget controllers to account for variances
- A computerized information management system with the capacity 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><b>Sourcing vendor</b></p> <ul style="list-style-type: none"> <li>- Inadequate approval authorities</li> <li>- Specific brand / sole supplier is selected without competitive bidding</li> <li>- Same supplier is selected for years</li> </ul>	<ul style="list-style-type: none"> <li>- Assessment panel / board should be used for high value purchase</li> <li>- Document justification for specific brand / sole supplier of valuable assets for independent review</li> <li>- Review approved vendor list / bring in new vendors for selection</li> <li>- Obtain pricing info from the market periodically</li> </ul>
<p><b>Quotation / Tender</b></p> <ul style="list-style-type: none"> <li>- Awarded vendor does not provide the best overall value to the company</li> </ul>	<ul style="list-style-type: none"> <li>- Vetting criteria should be pre-set with weighting of each assessment criterion</li> <li>- Request for price and technical submission in separate sealed envelopes</li> </ul>



# P2P – Common observations and principles / good practices at NGOs

Observations	Principles / Good practices
<b>Raising purchase order</b> - Purchases same product frequently	- Make it a rule for term contracts / bulk purchases for frequently purchased items
<b>Payment</b> - Original invoice is not used - Approver approves his own payment request	- 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
<b>Vendor's performance</b> - Vendor with poor performance is repeatedly engaged	- Introduce performance evaluation mechanism - Suspend vendors with poor performance from future bidding for a specific period / Remove from approved vendor list as needed

# P2P – Common observations and principles / good practices at NGOs

Observations	Principles / Good practices
<p><b>Performing feasibility</b></p> <ul style="list-style-type: none"> <li>- The usage of an valuable equipment of an research &amp; development center may not be estimated on a reasonable basis led to low utilization</li> <li>- Feedback of public may not be considered / validated during planning stage led to project delay</li> </ul>	<ul style="list-style-type: none"> <li>- A minimum threshold of committed usage should be set as a reference for the decision of capital commitment</li> <li>- Usage of valuable equipment should be recorded and analyzed</li> <li>- Conduct survey at the initial planning stage to collect public's feedback</li> </ul>
<p><b>Contract management</b></p> <ul style="list-style-type: none"> <li>- Contract is not timely compiled and signed</li> <li>- Contracts was not separately and centrally managed and monitored against capital budget</li> <li>- Variation is not properly assessed and approved</li> </ul>	<ul style="list-style-type: none"> <li>- Contracts should be signed within reasonable timeframe</li> <li>- Contracts should be separately managed for individual capital project for project monitoring</li> <li>- Authority matrix for variation order (“VO”) should be set according to contract sum and nature of VO</li> </ul>

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

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

Observations	Principles / Good practices
<p><b>Petty cash / cash advance</b></p> <ul style="list-style-type: none"> <li>- Lack of segregation of duties between the role of cashier and accounting staff</li> <li>- No independent and ad hoc cash count</li> </ul>	<ul style="list-style-type: none"> <li>- Separate custody of cash and account recording</li> <li>- Set time limit for claims of petty cash reimbursement / cash advance</li> <li>- Reimbursement only upon submission of original invoice or receipt; Claim form should be signed by the staff responsible and the supervisor</li> <li>- Independent and ad hoc cash count</li> </ul>
<p><b>Corporate credit card</b></p> <ul style="list-style-type: none"> <li>- Director of Sales &amp; 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</li> </ul>	<ul style="list-style-type: none"> <li>- Auto-payment should be avoided</li> <li>- 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</li> </ul>

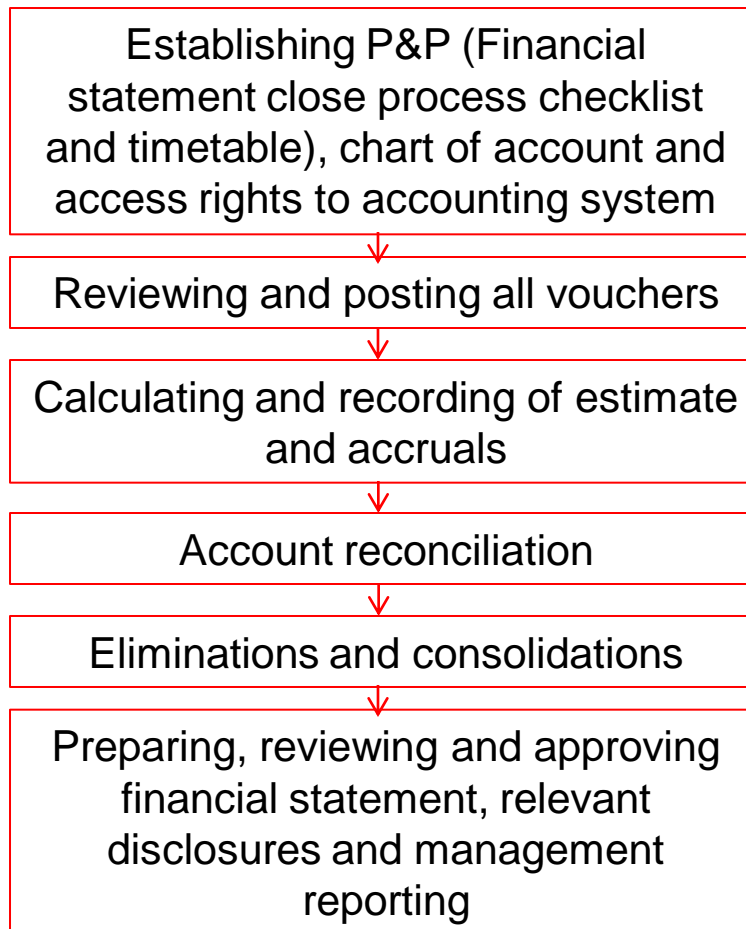
# Cash management – Common observations and principles / good practices at NGOs

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

# 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"><li>- Local accounting records were maintained in a local accounting system, while the corporate transactions were separately maintained in JD Edwards system.</li><li>- Comparison between the general ledger balances indicated variances of approximately USD1.5M in total assets, USD1.9M in total liabilities, and USD85K in year-to-date operating profit between the two records.</li></ul>	<ul style="list-style-type: none"><li>- Management was recommended to perform monthly reconciliation of the two records</li><li>- Timely follow up actions on reconciling items</li></ul>



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

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



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

Observations	Principles / Good practices
<ul style="list-style-type: none"><li>- KPIs are overly generalized / simplified</li><li>- Data input into the system is not specific to reflect business goals</li><li>- 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</li></ul>	<ul style="list-style-type: none"><li>- KPI should be set to fulfill at least the following principles:<ul style="list-style-type: none"><li>- Result-oriented or Relevant</li><li>- Specific</li><li>- Measurable</li><li>- Achievable</li><li>- Time-bound</li></ul></li></ul>



# 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



# Part 2 – Overview of internal audit



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# Objectives and scope of internal audit

## HKICPA Auditing Guideline – Guidance for internal auditors

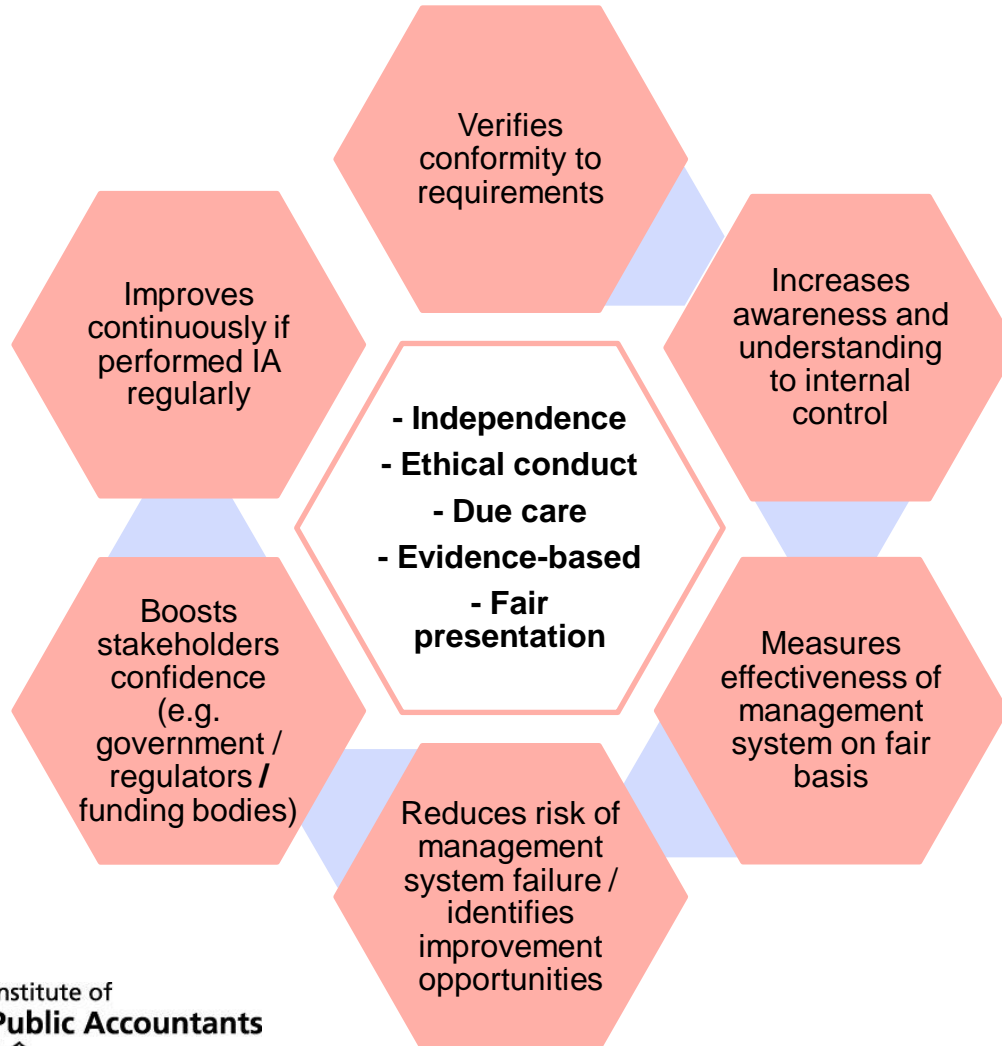
- Independent appraisal function
- Established by the management
- Review of internal control system as a service to the organization
- Objectively examines, evaluates and reports on the adequacy of internal control
- As a contribution to the proper, economic, efficient and effective use of resources



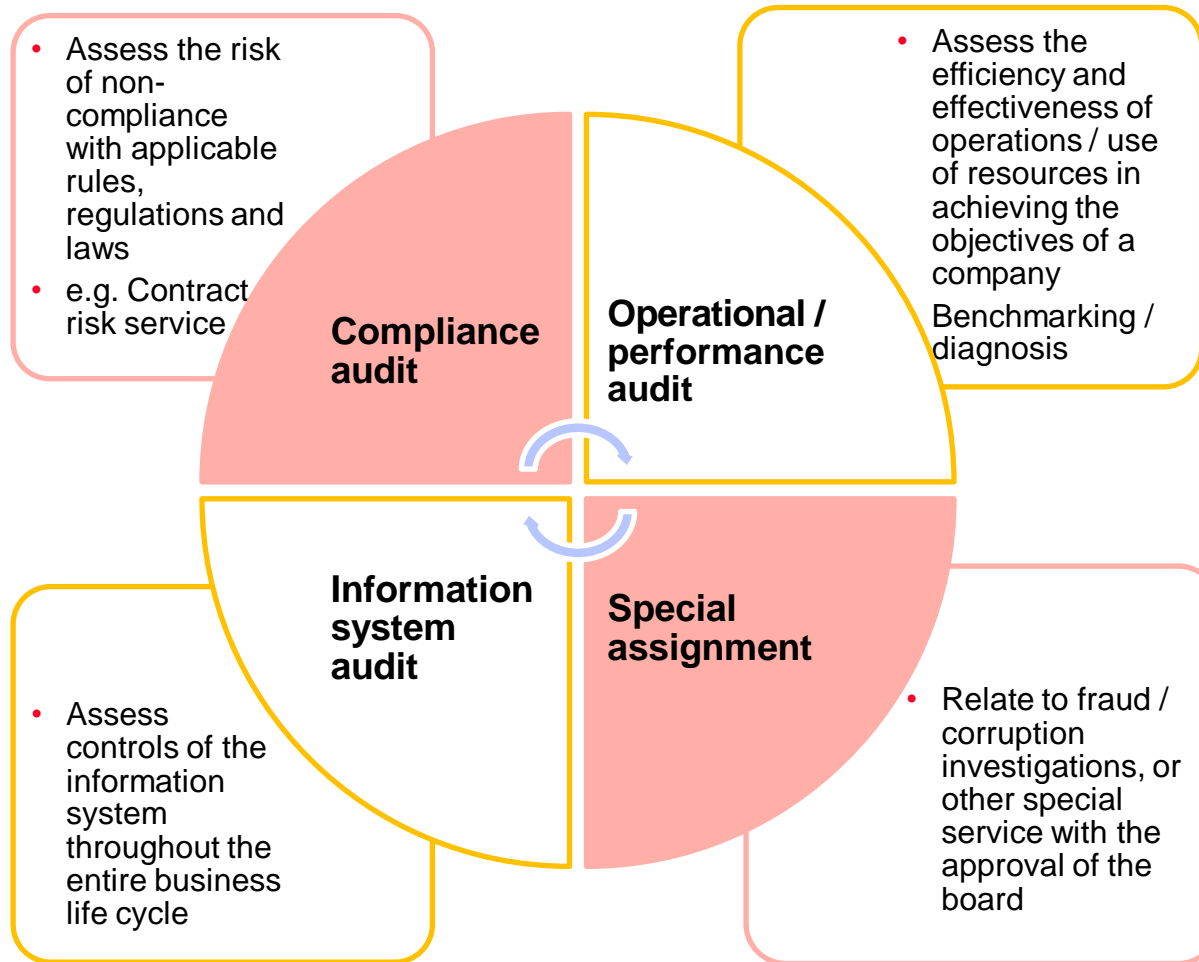
- Is not responsible to execute control activities
- Does not make management decision
- Is not responsible to design controls
- Does not only focus on financials but a much broader scope that covers all risks to a business



# Principles and values of internal audit



# Types of internal audit



## Snapshot of IA projects at NGOs

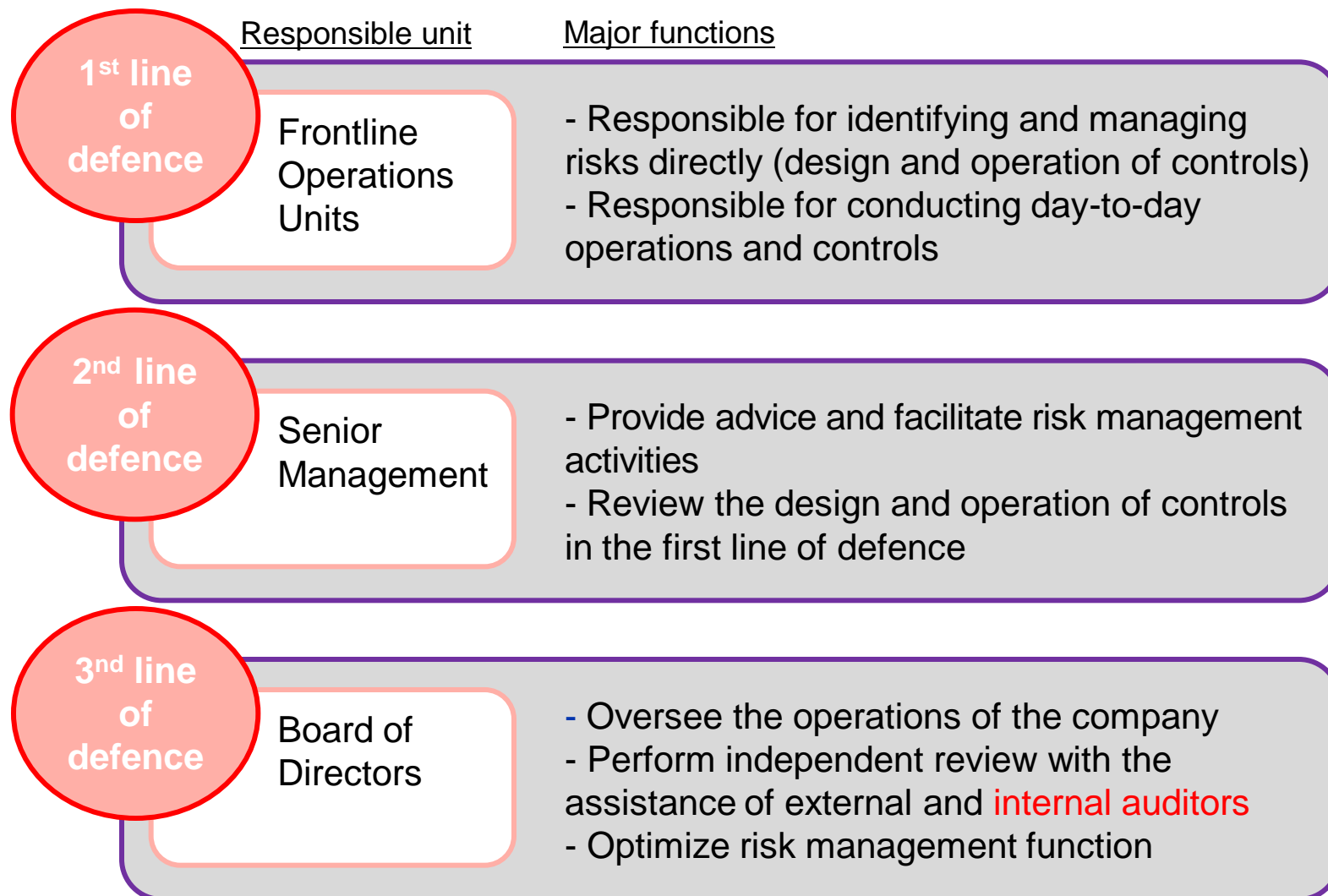
- Corporate governance reviews
- Enterprise risk assessment / management
- Operational reviews over sponsorship / project funding / procurement to pay / human resource / financial management / treasury etc.
- System implementation reviews of accounting / operating system
- Compliance check in world wide offices



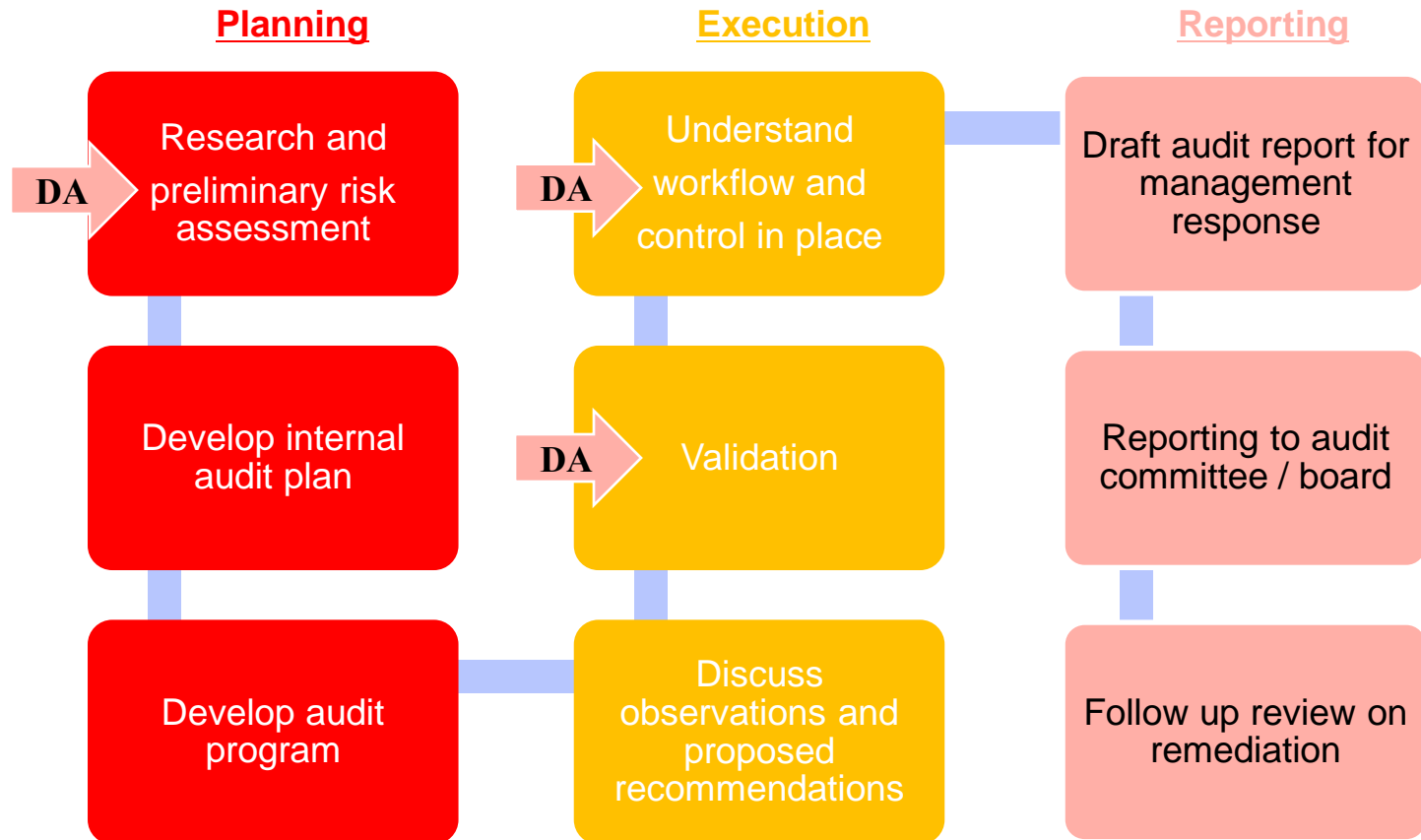
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# Internal audit in a governance structure



# Internal audit cycle



**DA** : Data analytics



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# Limited survey of internal audit models

Company nature	Analysis of sample companies
HK Public Sector	<ul style="list-style-type: none"> <li>▪ 50% of the companies outsourced the internal audit (“IA”) function while the remaining companies maintain an in-house IA team</li> <li>▪ Within the companies having in-house IA team, 50% have engaged professional firms to conduct special projects with specific reasons</li> </ul>
HK Listed Company	<ul style="list-style-type: none"> <li>• 90% of the HK listed companies maintain in-house IA function while the remaining 10% outsourced to professional firms</li> </ul>
Multinational companies (“MNCs”) with regional office based in HK	<ul style="list-style-type: none"> <li>▪ 50% companies co-source with professional firms for internal audit project execution</li> <li>▪ Around 25% MNCs outsource the IA function and the remaining 25% maintain in-house IA team</li> </ul>



# Limited survey of internal audit models

## Rationale behind the selection of internal audit model

### **Outsource:**

- Benefit the industrial trends / insights from outsourcing team
- Enjoy the flexibility of professional firm with world wide resource
- More cost effective in term of recruitment and training cost

### **Co-source:**

Emphasize staff stability for more routine reviews and leverage on specific knowledge / skills of professional firm in special projects

### **In-house:**

- Mainly operate in extremely niche industry where knowledge is not available in the market which the company has to train up the IA team internally
- Conglomerate company which has the resources for building up a sizable IA team for knowledge retention within a complex group



# Challenges / benefits overtime for NGOs with IA function

Area	Challenges in setting up IA function	Benefits of well established IA function
Organization culture	- Stable management team	
	<ul style="list-style-type: none"> <li>- Conservative to changes</li> <li>- Strong resistance to IA activities</li> </ul>	<ul style="list-style-type: none"> <li>- More welcome for innovative ideas</li> <li>- Familiar with IA approach</li> </ul>
Internal control environment / system	<ul style="list-style-type: none"> <li>- Remote support from governance team</li> <li>- Unclear tone at the top</li> <li>- More deficiencies within internal control system</li> </ul>	<ul style="list-style-type: none"> <li>- Effective support from the board</li> <li>- Clear tone at the top</li> <li>- Become mature after years of revolution</li> </ul>
Area of focus	- Focusing on reputational risk, relationships with government, public, privacy issues	
	- More efforts to promote internal control	- More efforts in different audit approach



# External reporting

## Auditors' report - common qualifications

- Non-consolidation – Hong Kong Financial Reporting Standard No. 10
- Limitations of scope
- Incomplete books and records

## Proper communications with auditors and stakeholders

- Audit planning re scope, timing and deliverables
- Closing meetings
- Management letter points



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# Q & A



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