

Presented by: **Jacky Lai, Partner, Assurance, Ernst & Young**

Date: **17 June 2016**

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

## **Implications and interpretation of financial statements and auditor's report**



Hong Kong Institute of  
Certified Public Accountants  
香港會計師公會

# Disclaimer

- ❖ The materials of this seminar / workshop / conference are intended to provide general information and guidance on the subject concerned. Examples and other materials in this seminar / workshop / conference are only for illustrative purposes and should not be relied upon for technical answers. The Hong Kong Institute of Certified Public Accountants (The Institute), the speaker(s) and the firm(s) that the speaker(s) is representing take no responsibility for any errors or omissions in, or for the loss incurred by individuals or companies due to the use of, the materials of this seminar / workshop / conference.
- ❖ No claims, action or legal proceedings in connection with this seminar / workshop / conference brought by any individuals or companies having reference to the materials on this seminar / workshop / conference will be entertained by the Institute, the speaker(s) and the firm(s) that the speaker(s) is representing.



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

# Agenda

- ❖ Overview of NGOs in Hong Kong
- ❖ Financial reporting requirements of NGOs
- ❖ Contents of audited financial statements
- ❖ Auditor's report
- ❖ Financial statements for fund-raising activity
- ❖ Analysis of financial statements
- ❖ Q&A session



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

# Overview of NGOs in Hong Kong



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

# Overview of NGOs in Hong Kong

- ❖ For 2015-16, 165 out of 170 non-governmental organizations (NGOs) under the government's subvention system are receiving Lump Sum Grant (LSG), and the subvention for these NGOs represents over 99% of the total recurrent subvention for 2015-16<sup>(1)</sup>.

<sup>(1)</sup> Source: Social Welfare Department



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

# Overview of NGOs in Hong Kong

- ❖ As at October 2015, the summary of the annual recurrent expenditures of the agency members of The Hong Kong Council of Social Service (HKCSS):

Annual Recurrent Expenditures	Number of Agency Members
Over HK\$50 million	75 (17%)
HK\$10 million – HK\$50 million	89 (20%)
HK\$5 million – HK\$10 million	42 (10%)
HK\$1.5 million – HK\$5 million	101 (23%)
Less than HK\$1.5 million	133 (30%)
	<b>440 (100%)</b>



# Overview of NGOs in Hong Kong

- ❖ Social service organizations provide a diversified portfolio of social welfare services. Apart from various types of social welfare services, agencies cooperate with other sectors to provide
  - employees retraining programmes
  - food banks
  - urban re-development social work services
  - social enterprises
- ❖ At present, social service organizations provide 90% of social service in Hong Kong, which benefit more than 6 million people.



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

# Overview of NGOs in Hong Kong

- ❖ There have been over 250 million beneficiaries, including:
  - children / youths
  - women
  - adults
  - senior citizens
  - people with disabilities or chronic illness
  - those having difficulties in employment
  - new arrivals
  - ethnic minorities
  - low-income families / Comprehensive Social Security Assistant Scheme (CSSA) recipients, etc.
- ❖ The wide variety and nature of services cover all strata of citizens.





# Overview of NGOs in Hong Kong

- ❖ The LSG Manual provides a self-contained and necessary reference for NGOs to operate under the LSG Subvention System, with a view to enhancing accountability, efficiency and cost-effectiveness in the use of public funds for the provision of welfare services.

# Overview of NGOs in Hong Kong

## ❖ *Definition of Small NGOs*

As recommended by the Lump Sum Grant Independent Review Committee, small NGOs are defined as NGOs with an annual LSG of less than \$5 million and an annual expenditure below \$10 million<sup>(1)</sup>.

<sup>(1)</sup> Source: Social Welfare Department



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

# Financial reporting requirements of NGOs



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

# Financial reporting requirements of NGOs

- ❖ Audited Financial Statements of NGOs
- ❖ Financial Statements of the specific division / programme / event, such as primary school, education programme, flag days etc
- ❖ Annual Financial Report ("AFR")



# Contents of audited financial statements



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

# Contents of audited financial statements

- ❖ Report of the Directors / the Executive Committee / the Board of Governors
- ❖ Independent Auditors' Report
- ❖ Audited Financial Statements:
  - Statement of comprehensive income / Income statement
  - Statement of financial position
  - Statement of changes in reserves
  - Statement of cash flows
  - Notes to financial statements



# Example of the financial statements

## ❖ Income statement

二零一四至二零一五年度經常費用收支表

Income Statement for the Year Ended 31 March 2015

	HK\$'000	HK\$'000
收入 Revenue		
善款 Funds Raised		
社會服務 Social Services Division		
教育服務 Education Division		
渡假營 Holiday Camps		
租金淨收入、利息及股息 Rental Income, Interest Income and Dividend Income		
什項 Sundry Income		



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

# Example of the financial statements

## ❖ Income statement

二零一四至二零一五年度經常費用收支表

Income Statement for the Year Ended 31 March 2015

	HK\$'000	HK\$'000
減： 支出		
Less : Expenditure		
社會服務		
Social Services Division		
教育服務		
Education Division		
渡假營		
Holiday Camps		
行政及其他		
Administration and others		
什項		
Sundry Expense		
減： 服務發展項目支出		
Less : Net expenses for development projects		
年度淨盈餘 (未有指定用途)		
Net Operating Surplus (not designated for specific purpose) for the year		



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會





# Example of the financial statements

## ❖ Statement of financial position

二零一五年三月三十一日資產負債表

Statement of Financial Position as at 31 March 2015

	HK\$'000
非流動資產	
Non-current Assets	
投資物業	
Investment properties	
固定資產	
Fixed assets	
共同控制公司 — 社區書院	
Interest in a jointly controlled entity – HPSHCC	
可供出售投資	
Available-for-sale financial assets	
定期存款 (> 1 yr)	
Time deposits (> 1 yr)	
	
	



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

# Example of the financial statements

## ❖ Statement of financial position

二零一五年三月三十一日資產負債表

Statement of Financial Position as at 31 March 2015

	HK\$'000
流動資產	
Current Assets	
存貨	
Inventories	
應收帳	
Accounts and other receivables	
教育單位來往帳	
Advances to Educational Units	
銀行存款及現金	
Cash at bank and in hand	



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會



# Example of the financial statements

## ❖ Statement of financial position

二零一五年三月三十一日資產負債表

Statement of Financial Position as at 31 March 2015

	HK\$'000
流動資產淨值 Net Current Assets	[ ]
總資產減流動負債 Total Assets less Current Liabilities	[ ]
非流動負債 Non-current Liabilities	
抵押貸款 Other loan, secured	
員工福利備用金 Provision for employee benefits	
儲備及基金 Funds and Reserves	[ ]



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

# Example of the financial statements

## STATEMENT OF CHANGES IN TOTAL FUNDS FOR THE YEAR ENDED 31ST MARCH, 2015

	Lump Sum Grant <u>Reserve Fund</u> HK\$	Provident Fund <u>Reserve</u> HK\$	Contributed <u>Fund</u> HK\$	Designated <u>Fund</u> HK\$	Accumulated <u>Fund</u> HK\$	<u>Total</u> HK\$
At 1st April, 2013						
Funds transfer						
Transfer from statement of comprehensive income and expenditure						
At 31st March, 2014 and 1st April, 2014 (Restated)						
Transfer from statement of comprehensive income and expenditure						
At 31st March, 2015						



# Example of the financial statements

## ❖ Statement of cash flows

STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED 31ST MARCH, 2015

---

	<u>2015</u> HK\$	<u>2014</u> HK\$ (Restated)
Operating activities		
Surplus for the year		
Interest income		
Interest expenses		
Dividend income		
Depreciation of property, plant and equipment		
Depreciation of investment properties		
Loss on disposal of property, plant and equipment		
Increase in fair value of investment held for trading		
Recovery of bad debt		
Write-off inventories		
(Write back of) increase in provision for long service payments		
Increase in (write back of) provision for unutilised annual leave		
Operating cashflows before movements in working capital		



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

# Example of the financial statements

## ❖ Statement of cash flows

STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED 31ST MARCH, 2015

	<u>2015</u> HK\$	<u>2014</u> HK\$ (Restated)
Operating cashflows before movements in working capital		
Decrease (increase) in inventories		
Decrease (increase) in other receivable, deposits and prepayments		
Increase in amount due from Social Welfare Department		
(Decrease) increase in amount due to Social Welfare Department		
Decrease in amount due from related parties		
Increase in net amounts due to Corps		
(Increase) decrease in amount due from Divisional Headquarters		
Increase (decrease) in net amount due to Educational Fund		
Increase (decrease) in amount due to International Headquarters		
Increase (decrease) in accounts payable and accrued charges		
Decrease in obligation on defined benefit plan		
Decrease in deferred income		
Cash generated from operating activities		
Interest paid		
Net cash generated from operating activities		



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

# Example of the financial statements

## ❖ Statement of cash flows

STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED 31ST MARCH, 2015

	<u>2015</u> HK\$	<u>2014</u> HK\$ (Restated)
Investing activities		
Increase in investment held for trading		
Dividend received		
Purchase of property, plant and equipment		
Deposit paid for acquisition of property, plant and equipment		
Repayment of loan from Corps		
Interest received		
Net cash used in investing activities		
Increase (decrease) in cash and cash equivalents		
Cash and cash equivalents at beginning of the year		
Cash and cash equivalents at end of the year, representing bank balances and cash		



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會



# Auditor's report

# Auditor's report

- ❖ According to Hong Kong Standard on Auditing 700 (Clarified) "Forming an Opinion and Reporting on Financial Statements" ("HKSA 700 (Clarified)"), the objectives of the auditor are:
  - to form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and
  - to express clearly that opinion through a written report that also describes the basis for that opinion.



# Auditor's report

- ❖ The auditor shall express an unmodified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

# Example of auditor's report

## INDEPENDENT AUDITOR'S REPORT

### TO THE FINANCE COUNCIL MEMBERS OF [REDACTED] COMBINED FINANCIAL STATEMENTS

---

We have audited the financial statements of the Combined Financial Statements of [REDACTED] [REDACTED] set out on pages 3 to 39, which comprise the statement of financial position as at 31st March, 2015, and the statement of comprehensive income and expenditure, statement of changes in total funds and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

#### **Finance Council Members' Responsibility for the Financial Statements**

The Finance Council members are responsible for the preparation of financial statements that give a true and fair view in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants, and for such internal control as the Finance Council members determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

# Example of auditor's report

## Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit and to report our opinion solely to you, as a body, in accordance with our agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report. We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to [REDACTED]'s preparation of the financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of [REDACTED]'s internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Finance Council members, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

# Example of auditor's report

## Opinion

In our opinion, the financial statements give a true and fair view of the state of affairs of [REDACTED] as at 31st March, 2015 and of the surplus and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards.



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

# Auditor's report

- ❖ According to Hong Kong Standard on Auditing 705 (Clarified) "Modifications to the Opinion in the Independent Auditor's Report" ("HKSA 705 (Clarified)"), the auditor shall modify the opinion in the auditor's report when:
  - the auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or
  - the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.



# Auditor's report – Qualified opinion

- ❖ The auditor shall express a qualified opinion when:
  - the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or
  - the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.





# Auditor's report – Adverse opinion

- ❖ The auditor shall express an adverse opinion when:
  - the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive, to the financial statements.



# Auditor's report – Disclaimer of opinion

- ❖ The auditor shall disclaim an opinion when:
  - the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.



# Auditor's report

## ❖ Types of modified opinions:

<i>Nature of Matter Giving Rise to the Modification</i>	<i>Auditor's Judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements</i>	
	<i>Material but Not Pervasive</i>	<i>Material and Pervasive</i>
Financial statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion



# Example of modified auditor's report

## ❖ Example 1:

### **Basis for qualified opinion**

In common with many charity organisations, there was limited evidence available to us for the income from donations and special fund raising projects. Although we have no reason to believe that any income for the year has not been recorded, there are no audit procedures that would enable us to confirm this. Accordingly, verification of income was limited to the amounts recorded in the Company's and the Group's records.

### **Qualified opinion arising from limitation of audit scope**

In our opinion, except for any adjustments that might have been found to be necessary had we been able to obtain sufficient evidence concerning the income from donations and special fund raising projects, the consolidated financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 March 2012, and of the Group's surplus and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

### **Report on matters under sections 141(4) and 141(6) of the Hong Kong Companies Ordinance**

In respect alone of the limitation on our work relating to the income from donations and special fund raising projects,

- (a) we have not obtained all the information and explanations that we considered necessary for the purpose of our audit; and
- (b) we were unable to determine whether proper books of account had been kept.



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

# Example of modified auditor's report

## ❖ Example 2:

### Basis for Qualified Opinion

As more fully explained in note 8 to the financial statements, consolidated financial statements have not been prepared in accordance with Hong Kong Accounting Standard No. 27 "Consolidated and Separate Financial Statements" issued by the Hong Kong Institute of Certified Public Accountants. It is not practicable to quantify the effects of the departure from these requirements.

### Qualified Opinion

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements give a true and fair view of the state of the Association's affairs as at 31st March 2013 and of its results and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.



# Financial statements for fund-raising activity



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

# Financial statements for fund-raising activity

- ❖ According to "Reference Guide on Best Practices for Charitable Fund-raising Activities" promulgated by Social Welfare Department (SWD), it is a good practice to make the financial statements of individual projects available to the public as far as practicable. It is encouraged to prepare separate externally audited (or reviewed) financial statements within 90 days of the completion of the project / event.



# Financial statements for fund-raising activity

- ❖ The statements shall be factual and accurate in all material respects, disclosing information which preferably includes:
  - the total revenue from the fund-raising event;
  - the total expenses of the fund-raising event;
  - the use of the net proceeds; and
  - the accounts are prepared in all material respects in accordance with the generally accepted accounting principles and standards established by HKICPA.



# Example of the financial statements for fund-raising activity

STATEMENT OF INCOME AND EXPENDITURE OF THE FUND-RAISING ACTIVITY  
HELD DURING THE PERIOD FROM JANUARY 2, 2016 TO JANUARY 3, 2016

---

Permit No.

██████████  
HK\$

INCOME

Donation received

██████████

EXPENDITURE

Catering

Licence

██████████

██████████

SURPLUS

██████████



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

# Example of the financial statements for fund-raising activity

NOTES TO THE STATEMENT OF INCOME AND EXPENDITURE OF THE FUND-RAISING  
ACTIVITY  
HELD DURING THE PERIOD FROM JANUARY 2, 2016 TO JANUARY 3, 2016

---

## 1. GENERAL

[REDACTED] ("Association") is incorporated in Hong Kong as a company limited by guarantee and not having a share capital. It is a charitable body engaged in the planning and organisation of social and educational activities as well as counselling services for children and young people through its various service units.

The fund-raising activity held by the Association and the proceeds raised therefore are solely designated for financing the non-subvented services of the Association.

The statement of income and expenditure is prepared solely for the purpose of satisfying the conditions stated in the Public Subscription Permit issued by the Social Welfare Department of the Government of the Hong Kong Special Administrative Region ("SWD") for the fund-raising activity.



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

# Example of the financial statements for fund-raising activity

NOTES TO THE STATEMENT OF INCOME AND EXPENDITURE OF THE FUND-RAISING  
ACTIVITY  
HELD DURING THE PERIOD FROM JANUARY 2, 2016 TO JANUARY 3, 2016

---

## 2. SIGNIFICANT ACCOUNTING POLICIES

The statement of income and expenditure has been prepared in accordance with the following significant accounting policies which comply with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants.

### Income recognition

Income is recognised when the Association's right to receive payment has been established.

### Expenditure recognition

Expenses are recognised using accrual basis.

3. The fund-raising activity was held during the period from January 2, 2016 to January 3, 2016 under the conditions stated in the Public Subscription Permit issued by the SWD.



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

# Example of the financial statements for fund-raising activity

## INDEPENDENT ASSURANCE REPORT

TO THE EXECUTIVE COMMITTEE OF

[REDACTED] ("the Permittee")

(Public Subscription Permit No.: [REDACTED])

Pursuant to the conditions stated in the Public Subscription Permit issued by the Social Welfare Department of the Government of the Hong Kong Special Administrative Region ("SWD"), we have been requested to report on the attached income and expenditure account of the Permittee's general charitable fund-raising activity held during the period from January 2, 2016 to January 3, 2016 ("the Event").

### **Respective responsibilities of the Executive Committee of the Permittee and practitioner**

The Executive Committee of the Permittee is responsible for preparing the attached income and expenditure account in accordance with the basis of preparation set out in note 2, setting out the gross subscriptions raised from the Event and the expenses incurred in connection with the Event, in order to comply with the conditions stated in the Public Subscription Permit issued by the SWD. This responsibility includes designing, implementing and maintaining internal controls relevant to the preparation and presentation of the income and expenditure account so that it reflects the subscriptions raised and expenses incurred in connection with the Event and is free from material misstatement.

It is our responsibility to form a conclusion on the attached income and expenditure account, based on our engagement, and to report our conclusion to you.



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

# Example of the financial statements for fund-raising activity

## Basis of conclusion

We conducted our engagement in accordance with Hong Kong Standard on Assurance Engagements 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information" and with reference to Practice Note 850 "Reporting on Flag days and General Charitable Fund-raising Activities Covered by Public Subscription Permits issued by the Social Welfare Department" issued by the Hong Kong Institute of Certified Public Accountants.

The work undertaken in connection with this engagement is less in scope than an audit conducted in accordance with Hong Kong Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Furthermore, due to the nature of cash receipts and expenses relating to the Event, it was not practicable for us to determine whether the income and expenditure account and the books and records of the Permittee include all transactions relating to the Event. It was impracticable for us to quantify the potential impact of this on the income and expenditure account. Accordingly, our report relates solely to the income and expenditure account prepared from transactions that have been recorded in the Permittee's books and records.

Our engagement included carrying out limited procedures for obtaining sufficient appropriate evidence to be able to draw a conclusion, such as inquiries primarily of persons responsible for financial and accounting matters and other procedures we considered necessary.



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

# Example of the financial statements for fund-raising activity

## Conclusion

Based on the foregoing, we report that nothing has come to our attention that causes us to believe that the attached income and expenditure account does not reflect, in all material respects, the gross subscriptions raised and the expenses incurred by the Permittee in respect of the Event that have been recorded in its books and records made available to us in accordance with the basis of preparation set out in note 2.

## Use of report

This report is intended solely for the purpose of assisting the Permittee to satisfy the conditions stated in the Public Subscription Permit issued by SWD in connection with the Event and is not intended to be, and should not be, used for any other purpose. We agree that a copy of this report may be provided to the Director of Social Welfare without further comment from us.



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

# Analysis of financial statements



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

# Analysis of financial statements

- ❖ Surplus / (deficit) for the year
- ❖ Sources of Revenue
- ❖ General Fund / Accumulated Surplus/(deficit)
- ❖ Liquidity / Going concern review
- ❖ Financial Stability
- ❖ Growth and Development
- ❖ Transparency
- ❖ Integrity to organization's aims and objectives





# Analysis of financial statements

## ❖ Surplus / (deficit) for the year

- For profit organization, the larger the surplus the better.
- However, there is no clear rule as to whether having surplus or deficit is good for a NGO.



# Analysis of financial statements

## ❖ Surplus / (deficit) for the year

### Other considerations:

- A balanced income statement, i.e. no surplus or no deficit, may indicate how well the management is making ends meet
- A deficit may give the NGO a good reason for fund raising
- A surplus may help the NGO to accumulate resources for future development of new innovative programmes prior to funding support from outside bodies



# Analysis of financial statements

## ❖ Surplus / (deficit) for the year

### Other considerations:

- Owing to the non-standardized methods of dealing with depreciation and various types of provisions, such as provisions for major repair and maintenance, the so-called surplus or deficit may vary from year to year.
- For example, where there is a major purchase of equipment in particular year and the total amount is taken as an expense instead of acquisition of asset, the surplus will be reduced (or deficit increased).



# Analysis of financial statements

## ❖ Sources of revenue

- An important part of the Income Statement is the various sources of revenue. Generally, there are three major sources:
  - Subvention from SWD
  - Fees and charges
  - Donations received or funds raised for general operations



# Analysis of financial statements

## ❖ Sources of revenue

- The percentage of SWD subvention measures the dependency of the NGO on government.
- This percentage measures how well the NGO can do more than just the main stream services and is willing to find resources to develop new services or any services not subvented by the government.



# Analysis of financial statements

## ❖ Sources of revenue

- The percentage of fees and charges measures the extent to which the NGO recovers its cost of operation.
- If this percentage is high, it means that the NGO should keep a close eye on the relativity of fees to operating expenses. The timing of adjusting fees becomes crucial.



# Analysis of financial statements

## ❖ Sources of revenue

- The major important point about donations to support general operations is their stability. For this reason, we may have to look at the variation of this sources of revenue over a number of years, before we can conclude about its stability.
- This has important implications on budgeting and fund-raising effort.

# Analysis of financial statements

## ❖ Sources of revenue

- Another important source of revenue is donations for designated purpose. It measures the extent to which the NGO is able to raise funds for specific programmes or projects.
- However, it does not affect financial stability of the NGO. When there is no such fund, there will be no such related activities.



# Analysis of financial statements

## ❖ **General fund / Accumulated surplus / (deficit)**

- This is equivalent to the total retained earnings for business.
- A large accumulated deficit:
  - indicates that the NGO is not financially healthy (or solvent)
  - means that the NGO is "using" resources from other designated funds that are not supposed to be used for daily operation of the NGO
  - a sign of mismanagement



# Analysis of financial statements

## ❖ **General fund / Accumulated surplus / (deficit)**

- A large accumulated surplus may not be necessarily a good sign. Funds for NGO should be put into good use instead of saving them in the bank.
- Hoping to accumulate sufficient surplus to generate interest for operation is not quite realistic. Normally, the rate of return on investment for NGO is no more than 1 to 2 percent above inflation.

# Analysis of financial statements

## ❖ **General fund / Accumulated surplus / (deficit)**

- With a large accumulated surplus, the NGO is capable to do something more.
- The difficulty is to determine how much accumulated surplus is too much.



# Analysis of financial statements

## ❖ Liquidity / Going concern review

- Surplus / (deficit) for the year
- General fund / accumulated surplus / (deficit)
- Current ratio
  - = current assets / current liabilities
  - a market profitability ratio that measures whether or not an entity has enough resources to pay its debts over the next 12 months
  - acceptable current ratio varies from industry to industry and is generally between 1.5 and 2 for healthy business



# Analysis of financial statements

## ❖ Liquidity / Going concern review

- Quick ratio / Acid-test ratio
  - =  $(\text{current assets} - \text{inventories}) / \text{current liabilities}$
  - measures an entity's ability to meet its short-term obligations with its most liquid assets
- Cash and cash equivalents
  - normally, an amount of cash equivalent to 1 to 2 months of turnover is adequate for a NGO
  - compare  $[(\text{total cash} - \text{total expense}/12) \times \text{inflation rate}]$  with total interest income



# Analysis of financial statements

## ❖ Financial stability

- Whether it is reasonably stable for the organization to function with undue anxiety amongst the staff so that staff can concentrate on their professional duties



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

# Analysis of financial statements

## ❖ Growth and development

- Monitor some rates of change (such as rate of change in total expenditure, rate of change in subvented activities, etc) to see if they are consistent with management decision regarding the NGO's development
- Whether it is a growing or stagnant concern
- Whether the organization is managing its assets appropriately



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

# Analysis of financial statements

## ❖ Transparency

- Whether its accounts are clear and open to reflect the organization's real financial status



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會



# Analysis of financial statements

- ❖ **Integrity to organization's aims and objectives**
  - Whether the organization is using its resources to achieve organization's aims and objectives



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

# Q&A



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

**Thank you**



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會