# **Accounting** for Good

## Helping Charities Do Good Better

**Isabel Sim, Alfred Loh and Teo Chee Khiang**

*It is my hope that all accountants, including aspiring and retired, may read this book and be inspired to contribute; be it engaging in projects that are short, medium or long term and have local, national or international impact. All those involved in the Charity sector will also benefit from reading this book which will increase their awareness of issues on financial management in Charities.*

Mr Gerard Ee
Chairman, Charity Council

# ABOUT THE BOOK

The Institute of Singapore Chartered Accountants (ISCA) and the Centre for Social Development Asia (CSDA) at the Department of Social Work of the National University of Singapore, supported by the Charity Council and Chartered Institute of Management Accountants (CIMA), have come together to produce this book. It aims to explore the areas where accountants can volunteer their expertise to help the Charity sector in Singapore. The chapters cover the challenges and issues faced by Charities in the areas of financial accountability, risk management, full-cost accounting, and cash flow, reserves and investment management.

This book may serve as a reference to stakeholders to help them understand the accountability framework of Charities. It can also be used as a guide for Charities to better understand the intricacies of financial management and as a training manual for their staff. Hopefully, this book will be a useful resource to board members and management staff of Charities to help them improve the financial management of their organisations.


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The articles in Chapters 1 to 7 were first published in the IS Chartered Accountant Journal.

# CONTENTS

# FOREWORD BY CENTRE FOR SOCIAL DEVELOPMENT ASIA (CSDA)

The Centre for Social Development Asia (CSDA) is pleased to jointly launch this book with the Institute of Singapore Chartered Accountants (ISCA), titled 'Accounting for Good'. We appreciate the tireless efforts of all who have contributed in making this publication possible.

Charities need to maintain high standards of accountability and transparency as they are funded by donations and other public funds. Accountants can contribute their expertise to help Charities improve accountability and financial management so as to create a viable Charity sector in Singapore.

This book provides an overview of the Charity landscape and aims to encourage accountants to volunteer their skills and expertise. More importantly, this book serves as a reference to Charities' board members and management staff of Charities. Board members can use this book as a guide to better understand various aspects of financial management, so that they can better discharge their responsibilities. Charities can also use it as a training manual for their staff. It is envisaged that this book will be useful to all stakeholders in understanding the accountability framework for Charities.

Once again, we would like to commend the team on the launch of 'Accounting for Good', and we look forward to more future collaborations.

Dr S. Vasoo
Chairman, Centre for Social Development Asia
Department of Social Work
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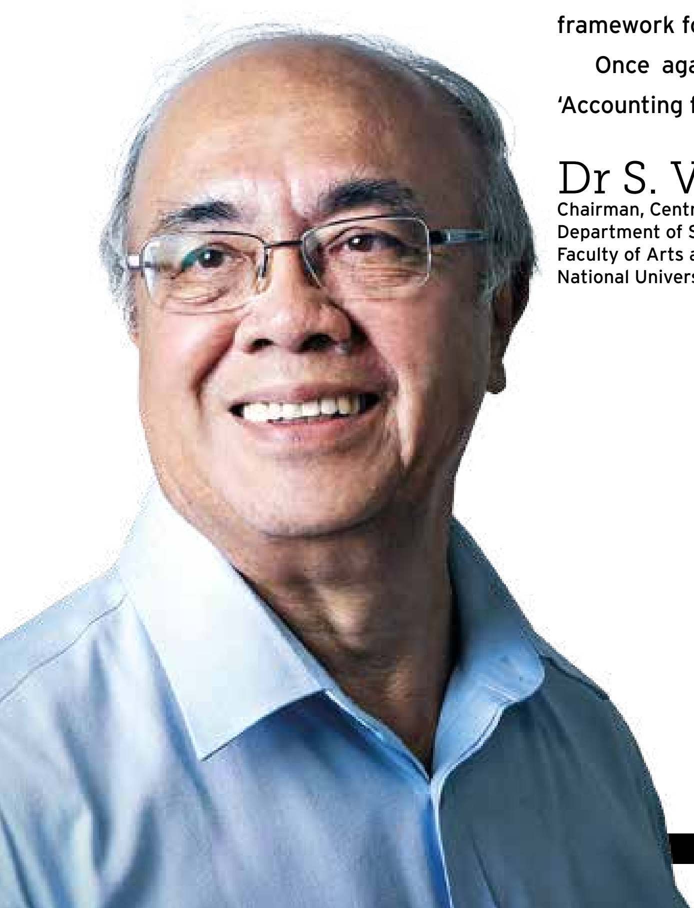


The business environment has become more challenging in today's VUCA (volatile, uncertain, complex, and ambiguous) world where evolving changes have made the future more unpredictable than ever. Like businesses, Charities are facing increasing pressure to adapt to new challenges, especially in the management of public funding. Charities that succeed demonstrate the ability to step up and meet these changing demands, despite the competitive operating environment and complexity brought about by digitalisation.

Having good financial management is critical to instilling confidence in, and drawing support from, donors and other stakeholders. Yet, Charities often struggle to keep accurate and up-to-date financial records. This is an area where ISCA members who are chartered accountants can volunteer their time and skills to help Charities do good better.

With their financial expertise and business acumen, coupled with deep-rooted values of integrity and professionalism, ISCA members possess the skills and knowledge to make a difference to organisations in the Charity sector. Although there are ISCA members who are already volunteering their time and services, more can be encouraged to support Charities and help to ensure they adopt good governance and financial controls. Hence, ISCA and the Centre for Social Development Asia, with the support of the Charity Council and the Chartered Institute of Management Accountants, have come together to develop a series of seven articles on 'Accounting for Good' that explore the areas where accountants can volunteer their skills and time. These articles, first published in the IS Chartered Accountant journal, are now compiled in this book for distribution to the accountancy and Charity communities.

We are pleased to be part of this collaboration which reflects our collective commitment towards raising the governance and management capabilities of our Charities. It is our hope that accounting professionals will share their knowledge and expertise to create value in this sector, and give back to the society we live in.

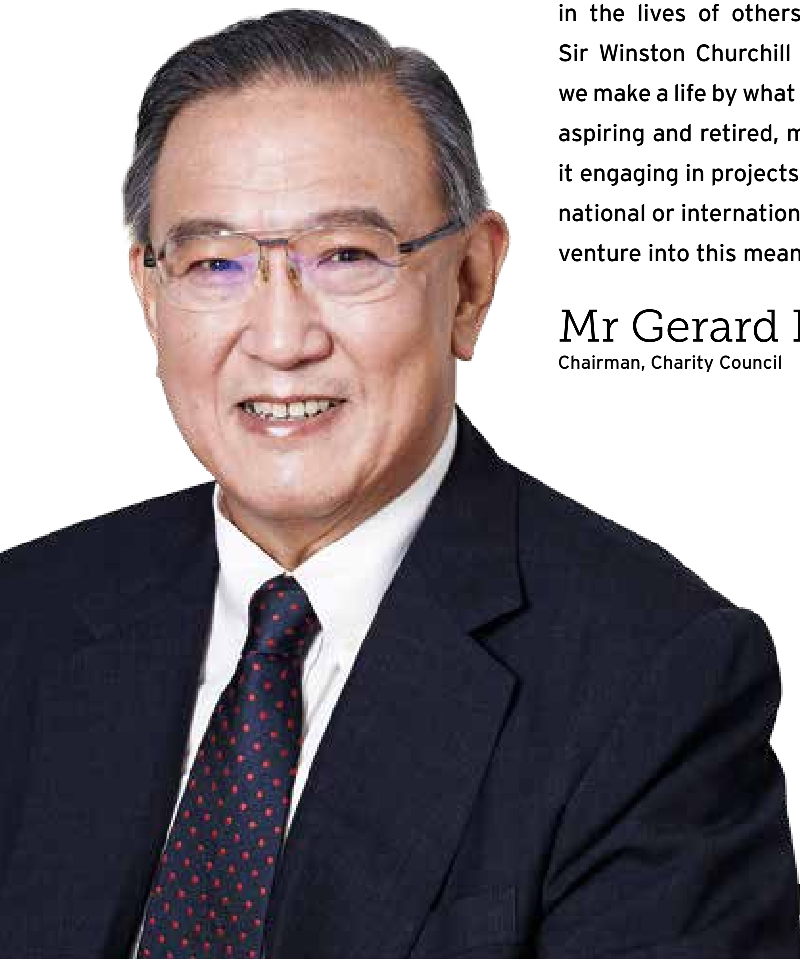
Mr Lee Fook Chiew
Chief Executive Officer
Institute of Singapore Chartered Accountants

Accounting for Good is written for accountants to better understand the Charity landscape for the purpose of volunteering their skills and experiences more effectively and meaningfully.

There is a need for good, qualified accountants in the Charity sector. Confidence in and support for Charities largely revolves around their accountability, in particular, usage of their funds and donations, as well as proper record keeping of their financial transactions and activities. Accountants can practise skills-based volunteerism and contribute their services and time to build Charities' capabilities in these areas.

I commend the Institute of Singapore Chartered Accountants and the Centre for Social Development Asia for this meaningful collaboration. Personally, one of the satisfactions derived from having volunteered in a professional capacity is knowing that your contributions build and sustain the capacity and capabilities of organisations which make a difference in the lives of others. This cannot be readily replicated elsewhere. As Sir Winston Churchill once said, "We make a living by what we get, but we make a life by what we give." It is my hope that all accountants, including aspiring and retired, may read this book and be inspired to contribute; be it engaging in projects that are short, medium or long term and have local, national or international impact. I would also like to urge all accountants to venture into this meaningful endeavour.

Mr Gerard Ee
Chairman, Charity Council



I wish to congratulate the National University of Singapore (NUS) on the publication of this book on 'Accounting for Good'. We are proud to be part of this effort.

The forces affecting how Charity organisations operate have changed a great deal over the decades. Today, such organisations are often confronted with the need to be more sensitive to the competitive nature of acquiring funds and to better manage how these funds are used.

I am pleased to note the introduction of components of management accounting in this book, such as cost accounting, governance and risk management. Through good management accounting practices, Charity organisations will be able to know the real cost of providing services, how to plan strategically and better manage their resources. It will also promote an effective and efficient delivery of services and give donors the confidence and trust that the funds are well managed for the benefit of the beneficiaries.

Once again, my sincere congratulations to the NUS team.

Mr Venkkat Ramanan, FCMA, CGMA
Regional Vice President, Asia Pacific
Chartered Institute of Management Accountants (CIMA)

# INTRODUCTION

The Charity sector, described as the "third sector" in the UK and elsewhere, contributes to society through its social value creation. A strong Charity sector is critical to the development of a vibrant community.[1] It serves as a foundation for forging social networks between individuals and institutions, and supports the creation of a civil society with a strong social fabric and vibrant communities.

Charities rely largely on donations and grants from individuals, government entities and other organisations to conduct their activities[2]. In turn, both stakeholders and the government expect Charities to be accountable and transparent in the way they utilise resources allocated to them.

The process of Charities here becoming increasingly accountable and transparent is already underway. As Ms Grace Fu, Minister for Culture, Community and Youth, noted last year, "Over the years, Singapore's Charity sector has been evolving to meet the diverse needs of Singaporeans. In particular, we see more Charities focused on raising their governance standards and accountability to build public confidence. I hope more corporates will heed the call from our Charities and see the value in corporate giving, either in donations or with time. By working together, we can make Singapore a more caring and giving nation."[3]

This book aims to help move this process along by providing insights into the underlying challenges and issues faced by the Charity sector. Through this, we hope that accountants can identify the areas they can get involved in.

Chapter 1 outlines the characteristics of Singapore's Charity sector and the challenges before it while Chapters 2 and 3 provide an overview of the regulatory framework for Charities in Singapore. These two chapters examine the measures put in place to ensure that Charities are accountable and transparent.

To enhance public trust, Charities should also look into improving their organisational governance, specifically how they manage risks. Chapter 4 (Risk Management, Internal Controls, Internal Audit) explains the need for Charities to manage risks and explores how they can build an effective risk management model by implementing internal controls and conducting internal audits.

Increasingly, donors are seeking more information to make better giving decisions. At the same time, Charities are also facing increasing competition for funds. By providing greater transparency about the full costs of their programmes, Charities can better articulate their strategies to donors and secure sustainable funding. Chapter 5 (Full-Cost Accounting in the Charity Sector) examines how Charities can benefit from adopting full-cost accounting systems and explores how accountants can help Charities to address the challenges associated with implementing these systems.

A major challenge faced by Charities is the management of cash flow, given the inherently unpredictable nature of their income. A shortage of cash to pay for recurring expenditures can be a major risk factor for a Charity. Chapter 6 (Cash Flow Management in Charities) explains the importance of understanding the characteristics of different revenue streams when forecasting and managing cash flow.

As a safeguard against income unpredictability and to ensure long-term financial sustainability, Charities should also look into building up their reserves. The factors to take into account in setting an appropriate level of reserves are discussed in Chapter 7 (Reserves and Investment Management in Charities). The chapter also explains why Charities should also consider developing investment policies and guidelines to better manage their reserves as this could generate an additional source of income.

There are many ways that accountants can help the Charity sector and we hope this book will be helpful to both accountants and charitable organisations. We strongly believe that everyone can make a difference. As Mother Teresa once said: "I alone cannot change the world, but I can cast a stone across the waters to create many ripples".

[1] De Vita, C. J. & Fleming, C. (2001). ***Building Capacity in Nonprofit Organizations.*** **Washington D.C: The Urban Institute.**

[2] Sim, I., Ghoh, C., Loh, A., & Chiu, M. (2015). *The Social Service Sector in Singapore: An Exploratory Study on the Financial Characteristics of Institutions of a Public Character (IPCs) in the Social Service Sector.* Retrieved from http://www.fas.nus.edu.sg/swk/doc/CSDA%20Exploratory%20Studies%20on%20Fundraising%20Practices%20Full%20Report%20Reduced%20size.pdf

[3] Adapted from Charity Transparency and Governance Awards 2016 Speech. Retrieved from https://www.mccy.gov.sg/en/news/speeches/2016/Sep/Charity_Governance_And_Transparency_Awards.aspx

*Charities in Singapore need to have more accountability and better financial management. That’s where accountants can contribute to make a difference.*

Dr S. Vasoo

Chairman, Centre for Social Development Asia
Department of Social Work
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National University of Singapore

CHAPTER 1

# HELPING CHARITIES DO GOOD BETTER

Charities contribute to society through their social value creation. A flourishing Charity sector can add value to community life because Charities help to maintain important social relationships in civil society. In recent years, the Singapore government has devoted considerable resources to building new social service capabilities and deepening competencies to better serve the needs of the various groups of the population. Like other organisations, Charities operate in a rapidly-changing and competitive environment. To adapt to the changing circumstances, Hsieh Fu Hua, President of National Council of Social Service, has pointed out the need for Charities to adopt a business mindset in organising and managing their activities.[1] Additionally, as a result of major scandals and misuse of funds both here and overseas, Charities are also under increased pressure to improve accountability. There are, therefore, many areas in which accountants can help Charities do good better – from financial reporting to financial management.

This chapter introduces accountants to the local Charity landscape, and highlights the importance of financial accountability as well as the challenges faced by Charities. The regulatory framework of Charities is discussed in the next two chapters.

## SINGAPORE'S CHARITY LANDSCAPE

Charities operate on a non-profit basis. They are set up exclusively for charitable purposes[2], to carry out activities to achieve these purposes to benefit the public. The Commissioner of Charities (COC), along with the Sector Administrators[3], regulate Singapore's Charity sector. Under the Charities Act, the objectives of the Commissioner include:

- To maintain public trust and confidence in Charities;
- Promote compliance by Charities;
- Promote effective use of charitable resources, and
- Enhance the accountability of Charities to donors, beneficiaries and the general public.

> **"Charities must be financially accountable to earn trust from donors and other stakeholders. Keeping accurate and up-to-date financial records is one way for Charities to connect with their donors and stakeholders."**
>
> GERARD EE
> PRESIDENT, ISCA AND CHAIRMAN, CHARITY COUNCIL

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[1] Tan, T. (2015). Rewriting the Rules of Social Service. *The AlumNUS* magazine, Issue 103, 18-20; http://alumnet.nus.edu.sg/magazine/2015October.pdf

[2] The recognised charitable purposes include the relief of poverty, the advancement of education, the advancement of religion, and other purposes beneficial to the community.

[3] The five Sector Administrators are Ministry of Social and Family Development, Ministry of Health, Ministry of Education, Sport Singapore, and People's Association.

[4] Charities (Institutions of A Public Character) Regulations (Cap 37, Rg 5, 2008 Rev Ed)

[5] Charities under 'Others' include charities set up for animal welfare, environment conservation and youth development.


Table 1 Distribution of Charities by Registration Status and IPC Status, by Sector (2014)

| Sector | Total Registered | | Total IPCs | |
|---|---|---|---|---|
| | Number | Percentage (%) | Number | Percentage (%) |
| Sports | 64 | 2.9 | 39 | 6.4 |
| Community | 88 | 4.0 | 71 | 11.6 |
| Education | 119 | 5.5 | 43 | 7.0 |
| Arts & Heritage | 124 | 5.7 | 67 | 11.0 |
| Health | 131 | 6.0 | 78 | 12.7 |
| Social & Welfare | 364 | 16.7 | 220 | 35.9 |
| Religious | 1,071 | 49.1 | - | - |
| Others[5] | 219 | 10.1 | 94 | 15.4 |
| Total | 2,180 | 100 | 612 | 100 |



Some registered Charities hold the status of Institutions of a Public Character (IPC), which allow them to issue tax-deductible receipts to donors. To qualify as an IPC, one of the requirements is that the Charity must be dedicated to serving the needs of the community in Singapore as a whole and is not confined to sectional interests or groups of persons based on race, belief or religion.[4]

In Singapore, the number of registered Charities has been growing over the last decade, from 1,807 in 2005 to 2,180 in 2014. Over half of them (52%) were small, with annual receipts of less than S$250,000. There were 612 IPCs, with the majority from the Social and Welfare sector (Table 1).

## FINANCIAL ACCOUNTABILITY IN CHARITIES

An objective of the Charities Act is to enhance the accountability of Charities to donors, beneficiaries and the general public. Accountability can be understood as the Charities' 'answerability' to their stakeholders. There are various elements to accountability including finance, accounting, governance, transparency, compliance and trust. Trust is arguably a Charity's single most important asset. Preserving trust ensures continual support from the donors and other stakeholders.

Gerard Ee, President of the Institute of Singapore Chartered Accountants (ISCA) and Chairman of the Charity Council, explains, "Charities have a moral obligation to be accountable for their funds and accounts. This instils a sense of confidence in stakeholders to continue their support for the Charities. Therefore, Charities must be financially accountable to earn trust from donors and other stakeholders. Keeping accurate and up-to-date financial records is one way for Charities to connect with their donors and stakeholders."

Charities must have proper bookkeeping, financial management and internal controls in place to ensure accountability. Charities need to comply with laws and regulations, for example, financial statements must be prepared in accordance with the applicable accounting standards, and annual reports must be prepared to keep the stakeholders informed of the Charities' activities.

If there is poor financial accountability, financial mismanagement or even fraud, Charities could end up in trouble. One recent high-profile case is that of the Kids Company in the United Kingdom (box story, left). The Charity collapsed in August 2015, just days after receiving a £3-million restructuring grant from the Cabinet Office.

## Kids Company

Founded in 1996 by Camila Batmanghelidjh to provide support to vulnerable young people, Kids Company was a highly-celebrated Charity with high-profile supporters including Prime Minister David Cameron, business elites and many celebrities. The Charity continued to receive substantial government funding over the years despite a number of red flags over the years, such as:

- In 2001, a grant-making body, Pilgrim Trust, terminated its £2-million grant on grounds that the Charity was unable to provide the required financial information.
- In 2002, the Charity Commission was informed about concerns as to whether Kids Company was sufficiently competent.
- In 2006, the trustees were informed that it had "weak finances, conflicting information about number of users" and "the absence to date of any internal attempt even to track and record results".
- In 2010, the trustees were warned that "the organisation continues to grow very fast, and has low reserves relative to its size".
- In 2014, an audit commissioned by the Cabinet Office found that the Charity was facing a "serious cash flow" issue, and "without improving the cash position of the Charity, it is not possible to build reserves and invest in new activities and locations".
- In 2015, the government disbursed £7.3 million in grants with conditions on two occasions – £4.3-million grant in March 2015, for Kids Company's downsizing plan, but no plans were submitted; a further £3-million grant in July 2015, for restructuring purposes, with £880,000 used to pay off its overdue bills.
- Following its collapse, the 2016 report by the Public Administration Committee revealed the following:
  - "Negligent trustees" repeatedly ignored auditor's clear warnings about the precarious finances of the Charity;
  - The government was aware of the overstating in the number of clients, but did nothing about it;
  - Earlier intervention by the Charity Commission might have helped safeguard Kids Company.

The committee chairman Bernard Jenkin concluded that the collapse of Kids Company was "an extraordinary catalogue of failures of governance and control at every level – trustees, auditors, inspectors, regulators and government".

Sources: *BBC News* and *The Guardian*

**Trust is arguably a Charity's single most important asset. Preserving trust ensures continual support from the donors and other stakeholders.**

PHOTO SHUTTERSTOCK


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**Charities have indicated that they would need help in the following areas, in order of priority: management of reserves and investments, budgeting, cost accounting, cash flow management, development of accounting policies and procedures, internal audit and bookkeeping.**

## PROBLEMS FACED BY CHARITIES

Charities normally allocate the bulk of their funds towards helping beneficiaries, and often do not have adequate resources to support general overheads and the administrative functions. The problem is particularly acute for small Charities with annual receipts of less than S$250,000, which constitute more than half (52%) of Singapore's registered Charities. They normally have to rely on part-time bookkeepers or volunteers to keep their financial records. With only a few staff, it is often a challenge for them to implement internal control measures, such as segregation of duties, and maintaining checks and balances. As such, they typically lack the requisite financial management expertise to do well.

How can accountants help these Charities? In a 2015 survey[6] by the Charity Council, Charities have indicated that they would need help in the following areas, in order of priority – management of reserves and investments, budgeting, cost accounting, cash flow management,

PHOTO **SHUTTERSTOCK**

[6] Charity Council. (2015). *Inaugural Townhall Meeting.* www.charitycouncil.org.sg/en/Our%20Work/Events/2015/Inaugural%20Townhall%20Meeting.aspx


## Gerard Ee, the Volunteer Accountant

He is a man who wears many hats.

Mr Ee started his career as an accountant in 1974, and became a public accountant in 1976 until his retirement as a partner of Ernst & Young in 2005. As a volunteer accountant, he has been actively involved in the Charity sector throughout his professional life. With a passion for both the Charity and Corporate sectors, Mr Ee has served as President, National Council of Social Service and National Kidney Foundation; Board Member, Accounting and Corporate Regulatory Authority; Council Member, Accounting Standards Council, and Nominated Member of Parliament (1997 to 2002). He is currently President, ISCA, and Chairman, Charity Council, Changi General Hospital and Eastern Health Alliance. Here, Mr Ee shares the satisfaction he gets as a volunteer.

"Initially, I was not interested in volunteering. But when I started volunteering, I experienced the rewards of impacting other people's lives. The satisfaction is very different from when you buy a new watch for example. You feel happy with your new purchase for a while but after that, the happiness fades off, and you will be looking for the next thing to buy.

In contrast, when you volunteer – let's say in a Boys' Home – you can see someone being reformed, returning to school and contributing meaningfully to society. He may grow up to be successful. That personal satisfaction is lasting.

Many years down the road, when you sit back and reflect, and think of that person you helped, it will bring a smile to your face and a glow to your heart. The more you experience this satisfaction, the more you want to help. This long-lasting satisfaction comes from your own effort – and that's what life is all about. Such satisfaction is enduring and is something money cannot buy."

development of accounting policies and procedures, internal audit and bookkeeping. Without a doubt, accountants have the requisite skills to offer help in these areas.

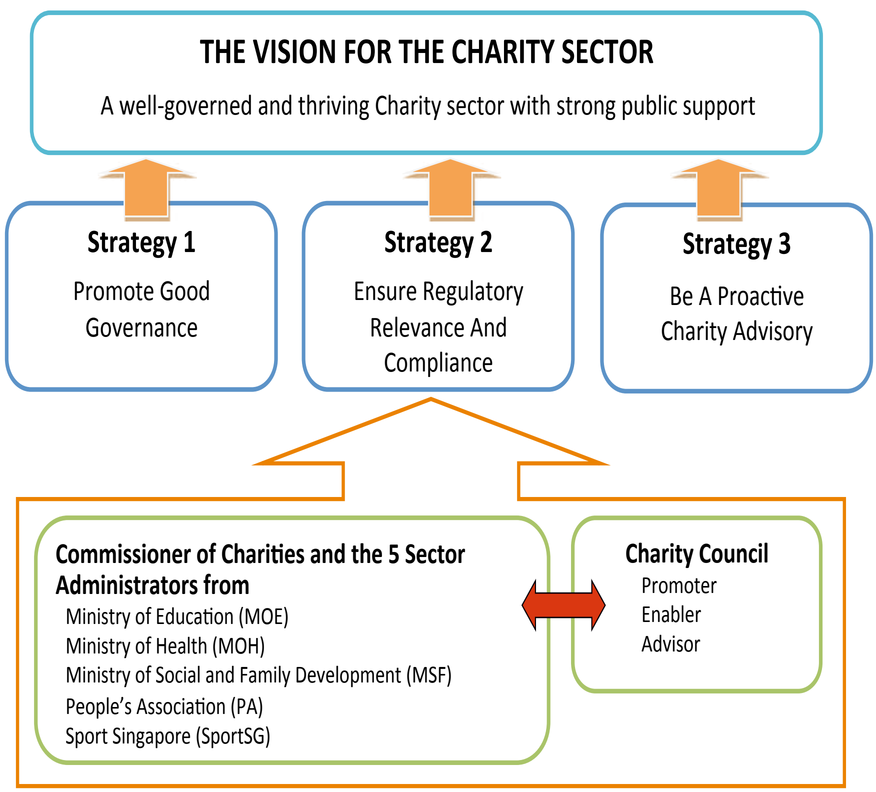
An example of skills-based volunteerism is best embodied by ISCA President and Charity Council Chairman Gerard Ee, a Chartered Accountant who is active in the Social Services sector. His expertise in auditing has made him an authority on corporate governance. Read about his experience as a volunteer (box story, above).

For accountants to help Charities do better, they would need to understand the regulatory framework within which Charities carry out their activities. This essentially encompasses the applicable accounting standards, the Charities Act and Regulations, as well as the Code of Governance for Charities and IPCs.

# THE REGULATORY FRAMEWORK OF CHARITIES (PART 1)

To better understand the regulatory framework that Charities operate within, this chapter will cover the legislation and Code of Governance pertaining to Charities and Institutions of a Public Character (IPCs). We extend our discussion, in the next chapter, to look at their financial reporting process and the challenges that they may face.

Figure 1 The Charity Governance Framework.
Adapted with permission from COC Annual Report 2014.




## ACCOUNTABILITY FOR CHARITIES: THE LEGAL FRAMEWORK

Charities rely largely on donations and grants from individuals, government entities and other organisations to carry out their charitable activities and are expected to utilise their funding in an accountable manner while maximising benefits to their targeted beneficiaries. In Singapore, the Office of the Commissioner of

[1] Charity Portal. (2016). *Other Requirements for Registration as a Charity or IPC.* https://www.charities.gov.sg/setting-up-a-charity/Registering-for-a-new-charity/Pages/Other%20Requirements%20for%20Registration%20as%20a%20Charity_IPC.aspx

[2] The types of legal entities, and benefits and drawbacks associated with each type are discussed in http://www.guidemesingapore.com/incorporation/other/non-profit-entity-part1

PHOTO SHUTTERSTOCK

Figure 2 **Types of legal entities**[2]

### Society

- This refers to a club, company, partnership or association of 10 or more persons, and is not already registered under any other law.
- Governed by Societies Act

### Company Limited by Guarantee (CLG)

- This refers to a company formed on the principle of having the liability of its members limited by the constitution to such amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound up. This includes companies carrying out non-profit-making activities tied to national or general public interest.
- Governed by Companies Act

### Charitable Trust

- This refers to an arrangement in the trust deed, where the owner donates property and/or funds to a Board of Trustees, who administers the assets for the benefits of other people (beneficiaries), for a stated objective.
- Governed by Trust Companies Act

**Charity**

Charities (COC) oversees the Charity sector, assisted by five Sector Administrators, while the Charity Council acts as an advisor to the COC on key regulatory issues, and is also a promoter and enabler of good governance in the Charity sector (Figure 1). The COC office periodically reviews the legislations relating to Charities to ensure their relevance, while strengthening the sector and building public trust.

## REGISTRATION OF CHARITIES AND IPCs

To register as a Charity, an organisation has to be any one of the three legal entities (Figure 2) and comply with the following conditions[1]:

- Purposes or objects of the organisation must be exclusively charitable;
- Organisation must have at least three governing board members, of whom at least two must be Singapore citizens or Permanent Residents, and
- Purposes or objects of the organisation must either be wholly or substantially beneficial to the community in Singapore.


Table 1 shows some additional features relating to registered Charities: A registered Charity can apply for IPC status if its activities are exclusively beneficial to the community in Singapore as a whole and not confined to sectional interests or groups of persons based on race, belief or religion. While IPCs can issue tax-deductible receipts to donors for qualifying donations, they are held to a higher standard of regulatory compliance and governance.

The Charities Act and other legislation govern, besides the registration of Charities, matters relating to deregistration, submission of accounts and fund-raising, among others. The key legislation are listed in Box Story 1.

Table 1 Additional features relating to Charities[3]

| Additional Features | Charity |
|---|---|
| Regulatory Body | Office of the COC |
| Submissions and Audit Requirements | Annual submissions to COC or Sector Administrators (within six months from the end of each financial year) which include:<br>• Annual Report and Financial Statement, and<br>• Governance Evaluation Checklist.<br>For IPCs, the filing of return on the tax-deductible donations received in the preceding calendar year by January 31.<br>Audit requirements<br>• All IPCs, CLG-Charities, and Charities with income/expenditure >$500k would need to be audited by a public accountant;<br>• Non-IPC Charities with income/expenditure a) between $250k and $500k – to be examined by an independent person who is member of ISCA, or audited by a public accountant; b) <$250k – to be examined by a competent independent examiner, or examined by an independent person who is member of ISCA, or audited by a public accountant. |
| Income Tax Requirement | Income tax exempted; no need to file tax returns. |
| Tax-deductible Donations | Only Charities with IPC status are eligible to receive tax-deductible donations. |
| Governed by | Charities Act |

## Box Story 1 Key Legislation Governing Charities and IPCs

### 1. Charities Act (Chapter 37)

This parent Act outlines the provisions, such as the administration and regulation of Charities and IPCs and fund-raising activities.

### 2. Charities (Registration of Charities) Regulations

Governs the conditions and application for registration (and deregistration) as a Charity.

### 3. Charities (Institutions of a Public Character) Regulations

Governs the registration of Charities as IPCs, the issuing of tax-deductible receipts, and additional reporting and disclosure requirements.

### 4. Charities (Large Charities) Regulations

Governs the large Charities, defined as those with gross annual receipts >$10 million in the two financial years immediately preceding the current financial year. It outlines regulations such as the minimum number of governing board members and audit requirements.

### 5. Charities (Fund-Raising Appeals for Local and Foreign Charitable Purposes) Regulations 2012

Governs fund-raising appeals (locally or overseas) for charitable purposes, the usage of donations and the 30/70 rule on fund-raising expenses, among others.

### 6. Charities (Accounts and Annual Report) Regulations 2011

Outlines the provisions regarding statement of accounts, annual report and audit requirements.

These legislation can be downloaded from the Charity Portal at https://www.charities.gov.sg/manage-your-charity/Pages/Legislation%20Governing%20Charity_IPC.aspx, or from Singapore Statutes Online.

PHOTO SHUTTERSTOCK


## CODE OF GOVERNANCE FOR CHARITIES AND IPCs

Besides the above legislation, Charities are encouraged to comply with the key principles and guidelines established in the "Code of Governance for Charities and Institutions of a Public Character"[4] introduced by the Charity Council in 2007 (and revised in 2011). The Code serves to provide guidance to board members regarding best governance and management practices that Charities could adopt to boost public confidence.

Figure 3 lists the nine areas highlighted in the Code. The Code is not mandatory and operates on the principle of "comply or explain". Smaller Charities, given resource constraints, face only a core set of guidelines while larger Charities and IPCs are encouraged to comply with a higher tier of governance principles.[5]

Figure 3 Nine Key Areas of Good Governance

| | |
|---|---|
| 1. Board Governance | The Board is responsible for the Charity's compliance with its governing instrument, all relevant laws and regulations. This section covers the importance of board independence, board and board committees' roles and responsibilities. |
| 2. Conflict of Interest | There should be clear policies and procedures set in place to declare, prevent and address potential conflicts of interest. |
| 3. Strategic Planning | Charities should have strategic and long-term plans for their sustainability. They are also encouraged to conduct regular review of the vision, mission and objectives to stay relevant to changing environment and needs. |
| 4. Programme Management | Outlines the operations and programmes directed towards achieving the objectives, clearly defined outcomes, and measurement of effectiveness and outcomes. |
| 5. Human Resource Management | Covers appropriate human resource and volunteer management policies. |
| 6. Financial Management & Controls | Relates to the basic operational controls, internal control systems for financial matters, budget planning and monitoring, capital asset management, and reserves management. |
| 7. Fund-raising Practices | Covers the best practices on the transparency and accountability of the Charity's fund-raising activities, such as the use of third-party fundraisers and accountability to donors. |
| 8. Disclosure & Transparency | Charities should be transparent and accountable in its operations. This includes making its annual report publicly available, and disclosure of remuneration and benefits. |
| 9. Public Image | Requires an accurate portrayal of image to be consistent with its charitable objectives. |

[3] Adapted from Anand, P, & Hayling, C. (2014). *Levers for change – Philanthropy in Select South East Asian Countries.* Social Insight Research Series. Singapore: Lien Centre for Social Innovation, Singapore Management University

[4] Charity Council. (2011). *Code of Governance for Charities and IPCs.* https://www.charities.gov.sg/Documents/Code_of_Governance_for_Charities_and_IPCs_%28English%29.pdf

[5] The different tiers are Basic I, Basic II, Enhanced and Advanced.

Charities and IPCs to which the Code is applicable are required to submit the Governance Evaluation Checklist (GEC) via the Charity Portal (www.charities.gov.sg) annually. The disclosure of all GECs on the Charity Portal has been in effect since August 2014.

According to Ang Hao Yao, Chairman of SATA CommHealth, adhering to the Code should not be seen as a mere box-ticking exercise. He believes that the Code can serve as a useful guide when Charities set up governance structures and procedures. It also serves to assist the boards in maintaining the highest standards of governance and, in turn, ensures that the respective communities receive the greatest benefit from the Charities (see Box Story 2).

The board is central to the Charity's governance. As such, the board members will have to be aware

## Box Story 2 Interview with Ang Hao Yao, Chairman, SATA CommHealth

In 2014, SATA CommHealth won the Special Commendation Award for Board Renewal and Strategic Repositioning in the Charity Governance Awards.[6] This recognition was given to the Charity's corporate governance practices that ensure the best interests of the Charity, especially on the selection of board members, and review of business foci and strategies.

"Adhering to the Code should not be seen as a box-ticking exercise but rather as a framework by which to organise governance. I have found that the way the Code is set up, in sections like Board Governance, Conflict of Interest, Human Resource and Financial Management, et cetera, serves as a useful guide when Charities set up governance structures and procedures.

"For example, the Code suggests that Charities consider setting term limits for board members. SATA CommHealth has thus adopted a maximum term limit for directors. The board therefore actively plans succession for Chairman, committee chairs and board members. This tone set at the top is expected to cascade to senior management and below. We believe this principle inculcates an organisational culture of continual improvement for our long-term sustainability.

"The Code also recommends that a board periodically review its mission and vision, approve a strategic plan, track and review programmes, ensure reviews are conducted for internal controls and processes, regularly monitor expenditures and approve the annual budget. I believe that these and the many other principles and guidelines of the Code can aid boards to maintain the highest standards of governance so as to ensure that the respective communities served receive the greatest benefit from the Charities."

[6] This is an initiative by the Charity Council to recognise Charities that have adopted the highest standards of governance.

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## Box Story 3 Conflicts of Interest and Related-party Transactions

One often-cited criticism of Charities' conduct revolves around financial deals that enriched either a board member or a staff member, due to the failure to properly handle so-called "related-party transactions". An interesting case in point is the UK Charity founded by the Queen's grandson to organise her recent 90th birthday celebrations. According to the popular press, the Charity was given a "red" risk rating by the Charity Commission, following revelation that his for-profit company was to be paid an "undisclosed" fee for organising the event, which turned the controversy into a "royal PR disaster".

Such conflicts-of-interest transactions involving a director are not in and of themselves improper. They are, in fact, quite common. It is the manner in which the director and board deal with and disclose the conflict that determines the propriety of a decision or transaction. Indeed, the Code specifies that Charities should have clear policies and procedures in place to declare, prevent and address potential conflicts of interest (Figure 3).

Given the risks and responsibilities, a written conflict-of-interest policy is strongly recommended. Despite this, in our review of the financial statements/annual reports of 200 IPCs for FY 2013, only 72 explicitly stated that they have such a policy in place for the board, and 54 for the staff. Of the 72 IPCs, only seven also explicitly stated that they have a "related-party transaction" policy.

Keeping the board and relevant stakeholders informed of financial transactions with insiders is a basic risk management step that can protect an organisation time and again. Accountants can play an important role to help more Charities put such procedural checks and balances in place.

of their responsibilities outlined in the Code, such as when dealing with issues relating to conflicts of interest, and disclosure and transparency (See Box Story 3).

## CONCLUSION

Charities engage in programmes and activities to provide services to individuals and communities, and depend largely on donations, government grants and other sources of income to support their mission. In turn, the funders and government would demand that the Charities are accountable for the way they obtain and use these resources. The most common mechanism of accountability is the formal report. As noted earlier, the Charities (Accounts and Annual Report) Regulations 2011 outlines the provisions regarding the statement of accounts, annual report and annual audit. To preserve public trust, such formal reporting is an important function for Charities. We will extend our discussion, in the next chapter, to look at Charities' financial reporting process and the challenges they may face.

# THE REGULATORY FRAMEWORK OF CHARITIES (PART 2)

Charities rely largely on donations and grants from individuals, government entities and other organisations to carry out their charitable activities. They are expected to utilise their funding responsibly and in an accountable manner. In the previous chapter, we provided an overview of the regulatory framework which governs the operations of Charities and promote accountability in the sector – such as the Charities Act and Code of Governance for Charities and Institutions of a Public Character (IPCs). Additionally, a common mechanism to promote accountability is via the formal financial reporting process. In this chapter, we extend our discussion to examine the accounting standards tailored for the sector – more specifically, the Charities Accounting Standard (CAS).

## FINANCIAL REPORTING FRAMEWORK FOR CHARITIES

Many countries, including Singapore, have adopted the International Financial Reporting Standards (IFRS) promulgated by the International Accounting Standards Board (IASB) to regulate financial reporting of Charities.[1] However, one common argument against IFRS is that the standards have been designed for the for-profit sector, and hence may need to undergo adjustment to suit non-profit entities.[2] In view of this, the Financial Accounting Standards Board (FASB) in the US had, in 2015, proposed sector-specific reporting standards for non-profit entities. According to Lee Klumpp, a member of the FASB's Not-for-Profit Advisory Committee, a fundamental goal of the proposal is to "make it easier for non-profit organisations to tell their stories and, at the same time, the people that rely on this information will obtain more clarity about the nature of the financial figures – how they were developed and what they really mean."[3]

It has also been recognised that a "one-size-fits-all" financial reporting approach may not be suitable for Charities, given their varied nature of operations and differing sizes. Thus, tiered or modified financial reporting frameworks have been introduced elsewhere to facilitate simpler and more relevant reporting.[4] For instance, New Zealand adopts a four-tier system that makes available simpler financial reporting frameworks for smaller or eligible Charities. In the UK, Charities can opt for the Financial Reporting Standard for Smaller Entities (FRSSE) if they meet the necessary criteria. Similarly, Charities in Singapore can opt to adopt the CAS.

[1] While Singapore has adopted substantially all IFRS issued by the IASB as SFRS, full convergence with IFRS for listed companies will only be achieved for FYs beginning on or after 1 January 2018.

[2] Irvine, H., & Ryan, C. (2013). Accounting regulation for charities: international responses to IFRS adoption. *Pacific Accounting Review*, Vol. 25 Issue 2, 124-144; http://dx.doi.org/10.1108/PAR-03-2012-0009

[3] Klumpp, L. (2015). Financial Accounting Standards Board proposes new accounting standards for nonprofits. *Nonprofit Business Advisor*, Vol. 2015 Issue 310, 5-8; http://dx.doi.org/10.1002/nba.30087

[4] Grant Thornton New Zealand. (2015). *New financial reporting requirements: Helping the Not for Profit sector navigate complexity.* http://www.grantthornton.co.nz/Publications/Corporates/new-financial-reporting-requirements-helping-the-Not-for-Profit-sector-navigate-complexity.html

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## CHARITIES ACCOUNTING STANDARD

Introduced in 2011, the CAS is a simpler financial reporting framework that is tailored to the needs of Charities. It was developed based on the requirements of the FRS, taking into account the context and circumstances relevant to the Charity sector. The CAS serves as an alternative set of accounting standards to the FRS, which also regulates the preparation and presentation of financial statements for eligible Charities.[5] It aims to better meet the needs of the Charity sector by making it easier for Charities to comply with the financial reporting requirements and provide information that is fit-for-purpose to stakeholders.

The objectives of the CAS are to:

- Improve the quality of financial reporting environment of Charities;
- Enhance the relevance, comparability and understandability of information presented in the financial statements of Charities;
- Assist those who are responsible for the preparation of the financial statements of Charities, and
- Reduce diversity in accounting practice and presentation across Charities.

In essence, the CAS captures the relevant requirements that are largely applicable to the local Charity sector and simplifies the reporting and disclosure processes. For instance, the CAS excludes some FRS requirements that are not applicable to Charities. It also prescribes how Charities should present their Statement of Financial Activities to give donors, beneficiaries as well as the general public greater insights as to how they receive and apply their income to meet their charitable objectives. Table 1 highlights some key differences between the CAS and the FRS.

[5] Charities that hold significant investments in any subsidiary, associate or joint venture that is not a Charity, however, are unable to adopt the CAS and are required to comply with the FRS.

[6] Adapted from Woo, E-Sah. (2012, May). Frameworks for charities. ACCA *Accounting and Business* magazine (Singapore Edition). Vol 15 Issue 5, 51-54; https://issuu.com/accaglobal_publications/docs/ab_sg_may12_comp?e=1142456/2609376

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# Interview with Woo E-Sah, Audit Partner, RSM Chio Lim LLP

Woo E-Sah serves as the industry leader of RSM Chio Lim LLP's Not-for-Profit Organisation (NPO) and Healthcare Practice. Her NPO team has assisted various NPOs with Audit, Tax, Advisory and Business Support Services. In the following interview excerpt, Ms Woo provides her expert opinion on the benefits of the CAS.

"CAS aims to provide a simpler framework for Charities in terms of recognition, measurement, disclosure and presentation."

As highlighted by Ms Woo, some significant areas that have been simplified are:

| | |
|---|---|
| **Investment in Financial Assets** | CAS requires the investment in financial assets to be measured at cost, without the need to consider the FRS 39 categories that the financial asset falls under. Any changes in fair value need not be accounted for in the income and expenditure statement or in the revaluation reserves under the Fund balance. |
| **FRS 107 *Financial Instruments: Disclosures*** | Disclosures under FRS 107 *Financial Instruments: Disclosures* are not required. |
| **Property, plant and equipment** | Unlike FRS, CAS dictates the cost model without requirements to assess impairment as this is not as applicable under the Charity context. |

Table 1 Comparative framework between the CAS and the FRS[6]

| Financial Reporting Standards (FRS) | Charities Accounting Standard (CAS) |
|---|---|
| **Presentation** | |
| Includes four Financial Statements:<br>• Statement of Financial Position<br>• Statement of Cash Flows<br>• Statement of Comprehensive Income<br>• Statement of Changes in Equity | • Statement of Financial Activities (SOFA) replaces Statement of Comprehensive Income and Statement of Changes in Equity. |
| Statement of Comprehensive Income presented by nature or by function. | SOFA is presented by major types of funds, example, restricted income and endowment funds. There is a need for a link between income and expenditure and type of activity category. |
| Third balance sheet required when there is restatement or reclassification in prior-year figures. | No third balance sheet is required. |
| **Asset-related Grant and Donations** | |
| Asset-related grants are allocated to income over the period in which such assets are used. | All asset-related grants and donations are categorised as income, to the extent that conditions attached, if any, have been fulfilled. Asset-related grants are then reduced over the useful life of the asset. |
| **Borrowing and Development Costs** | |
| Borrowing costs directly attributable to acquisition, construction or production of a qualifying asset and development costs are capitalised. | Borrowing costs and development costs are expensed to SOFA immediately. |

Woo E-Sah, Audit Partner of RSM Chio Lim LLP, is of the opinion that the CAS provides a simpler reporting framework for Charities in terms of recognition, measurement, disclosure and presentation. In the box story (blue box above Table 1), she highlights some main areas that have been simplified.

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## ADDRESSING CONCERNS WITH ADOPTING THE CAS

Although the CAS is intended to provide a simpler financial reporting framework for Charities, the CAS has yet to be widely adopted. Based on submitted financial statements in 2014 and 2015, only approximately 40% of the Charities have adopted CAS. Ms Woo believes that it could be beneficial for all Charities to adhere to the CAS. She says, "By making the CAS mandatory for all Charities, there will not be a mismatch for Charities adopting the FRS or the CAS on the presentation of financial statements and recognition of grants and donations. It also enhances comparability among Charities if similar standards are adopted."

Table 2 summarises the reasons provided by Charities for the low uptake of CAS, derived from a 2015 survey conducted during the inaugural townhall meeting organised by the Centre for Social Development Asia and the Charity Council.

Some Charities also harbour misunderstandings regarding the CAS, thinking that the CAS is of a "lower" standard than the FRS and thus, do not see the appeal of the CAS. In response, Gerard Ee, President of the Institute of Chartered Accountants (ISCA) and Chairman of the Charity Council, comments that this perception is incorrect.

[7] Adapted from our interview with Woo E-Sah, as well as an article authored by Suhaimi Salleh, CEO of SSA Consulting Group Pte Ld. The full article is available at https://www.charitycouncil.org.sg/en/Resources%20For%20You/Blog/Charities%20Accounting%20Standard.aspx.

[8] Under fund accounting, separate accounts have to be kept to differentiate the movements of restricted, unrestricted and designated funds.

Table 2 **Reasons behind the low transition rate of CAS**

| Reasons | Suggestions[7] |
|---|---|
| Easier to hire auditors who are familiar with the FRS | Accounting professionals working in Charities can register for modules and seminars offered by the Social Service Institute and the Institute of Singapore Chartered Accountants to familiarise themselves with the CAS. |
| Parent organisation is using the FRS | |
| Transition to the CAS would incur high administrative costs | Charities can tap into available funding from the Charity Council's VWO-Charities Capabilities Fund (VCF):<br>+ VCF local training grant to alleviate training costs;<br>+ VCF consultancy grant, which subsidises the cost of engaging external consultancy services relating to the CAS;<br>+ VCF Infocommunications Technology (ICT) grant also subsidises the cost of software for the adoption of the CAS. |

He explains that the CAS is simply a subset of the FRS with less extensive reporting requirements and as such, can benefit smaller Charities. Hence, he concludes, "It is a question of need rather than a question of higher order."

Ms Woo also addresses the technical misconception about fund accounting. She explains that contrary to what some may believe, the disclosure of either income and expenditure statement or balance sheet by fund categories does not only apply to Charities adopting the CAS. Fund accounting[8] remains the key feature of Charity accounting and is not in conflict with the FRS. In reality, Charities adopting the FRS are encouraged to adopt the presentation format of the SOFA as required by the CAS.

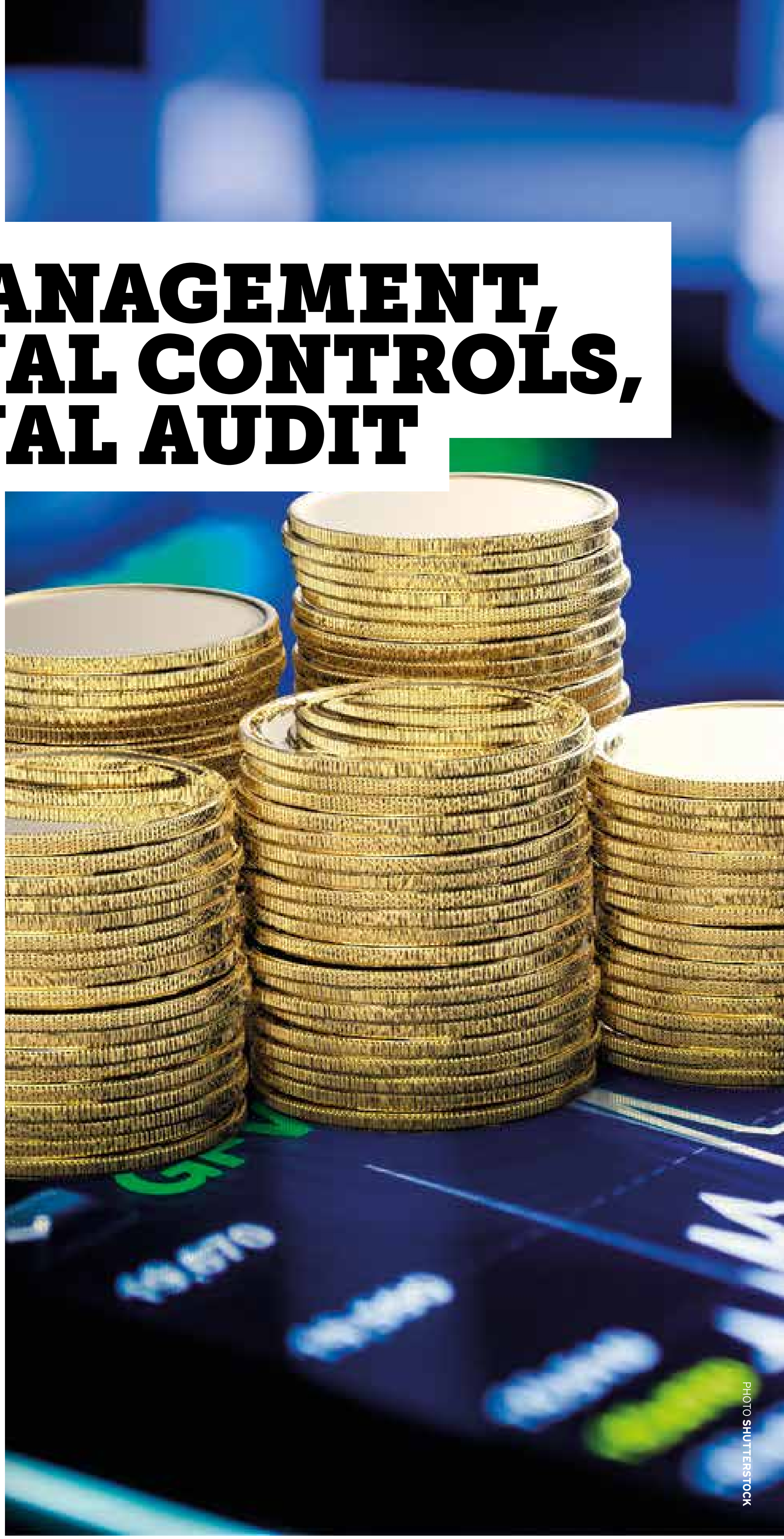
To further assist Charities, Ms Woo believes that accountants or auditors should also come forward and help Charities understand the similarities and differences between the FRS and CAS, and thereby make an informed decision in their choice.

## CONCLUSION

Charities are often volunteer-driven organisations, made up of committed individuals working for a cause. They are stewards of the public's trust, and are held to a high standard of integrity that they will use donations as promised. A strong regulatory framework will help to promote greater accountability of the Charity sector. To further earn the public's trust, an organisation could also look into improving its organisational governance – through the development of a framework and guidance on risk management, internal control and fraud deterrence. However, as more than half of Charities in Singapore are small in terms of their income size, many may not have formal hierarchies of management. Therefore, accountants could play an important role in helping these Charities develop a corporate-type management structure, and institute financial management practices that could be systematically used to prevent misuse and misappropriation of assets, such as occurring through theft or embezzlement. We will examine these aspects in the next chapter.

CHAPTER 4

# RISK MANAGEMENT, INTERNAL CONTROLS, INTERNAL AUDIT



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Charities are stewards of the public's trust and are held to high standards of integrity on how they manage and use their financial resources.

To enhance the public's trust, Charities could also look into improving their organisational governance, specifically on how they manage risks. This chapter explains the need for Charities to manage risks, and explores how Charities – even the smaller ones[1] – can build an effective risk management model through implementing internal controls and conducting internal audits.

## WHAT IS RISK MANAGEMENT?

Charities rely largely on the public for donations to carry out and sustain their missions. Fraud and misuse of funds can weaken the public trust in the Charity sector. "What can possibly go wrong?" "What should then be done to mitigate or manage it?" – these are two essential questions that all staff and board members should ask when managing an organisation. Besides the loss of assets and funds, such lapses could also have other detrimental effects, such as lowering the morale of staff and volunteers, that will inevitably impact the ability of the organisation to sustain itself. It is therefore critical for Charities to engage in sound

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[1] About half the number of Charities in Singapore are relatively small, with gross annual receipts of less than $250,000. Source: *Commissioner of Charities Annual Report 2015* published by Charities Unit, MCCY; www.charities.gov.sg/Publications/Pages/Publications.aspx

[2] UK Charity Commission. (2010). *Charities and Risk Management*. www.gov.uk/government/publications/charities-and-risk-management-cc26/charities-and-risk-management-cc26

[3] Adapted from UK Charity Commission. (2010). *Charities and Risk Management*. www.gov.uk/government/uploads/system/uploads/attachment_data/file/509704/cc26_lowink.pdf

risk management. This involves the identification of major risks that apply to them, as well as the development of strategies to mitigate these risks. In the UK, the Charity Commission[2] has recommended that Charities should also include appropriate statements in their annual reports to cover, for example, the person who is responsible for risk management.

## TYPES OF RISKS FACED BY CHARITIES

Charities are exposed to a diverse range of risks both financial and non-financial in nature. The nature and types of risks faced by an organisation would, generally, depend on its size as well as the type and complexity of activities it undertakes. Additionally, the wider environment in which the Charity operates, including the financial climate and any changes in legislations, has to be considered in assessing its risk exposure as well.

A system of classification, as illustrated in Table 1, provides a good way for Charities to ensure that the key areas of risk are considered and identified.

Generally, Charities are familiar with the need to manage financial risks. However, the management of the other categories of risk, such as operational risks, is equally important. Should any Charity not identify and manage its key risks adequately, a

**Table 1** Key categories of risks that Charities may potentially face[3]

| Risk category | Examples |
|---|---|
| Governance risks | Inappropriate organisational structure<br>Lack of relevant skills or commitment among the board and management<br>Conflicts of interest |
| Operational risks | Inability to achieve desired objectives and mission<br>Inability to sustain operations<br>Failure to safeguard assets |
| Financial risks | Inadequate disclosure of financial information<br>Over-dependency on limited income sources<br>Inadequate investment management policies |
| External risks | Poor public perception and reputation<br>Turbulent economic or political environment<br>Changing government policy |
| Compliance with law and regulations | Breach of trust<br>Non-compliance with regulatory requirements (example, fund-raising, running of care facilities, etc) |

simple incident would be all it takes to tarnish its reputation. As Warren Buffett once said, "It takes 20 years to build a reputation and five minutes to ruin it." A case in point relates to the incident in 2011 that was widely reported in the media, concerning the abuse of an elderly resident in a nursing home. While that lapse – which reflected the home's inability to provide adequate care for the elderly – was non-financial in nature, the incident nevertheless impaired the home's reputation.

## MITIGATING RISKS

Having in place formal risk management procedures to identify risks will help Charities to promptly respond and effectively deal with such risks when they occur. For example, when one Charity discovered missing funds from its accounts in FY 2014, its board was able to swiftly respond to the incident. Formal risk management procedures were already in place, which allowed the misconduct to be quickly detected. Most of the funds were recovered and the negative implications were thereby minimised.

As a regulatory measure, there are laws and guidelines to ensure that Charities have at least the basic risk management policies.[4] For example, the Charities Act stipulates that Charities are required to conduct annual audits or an examination of accounts. Additionally, both the Charities Act and Code of Governance for Charities and Institutions of a Public Character (IPCs) (2011) specify that IPCs should have policies

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[4] For more information, please refer to the relevant statutes for Charities at www.charities.gov.sg/manage-your-charity/Pages/Legislation%20Governing%20Charity_IPC.aspx and Code of Governance for Charities and IPCs, in its entirety, at www.charities.gov.sg/Documents/Code_of_Governance_for_Charities_and_IPCs_%28English%29.pdf

[5] Committee of Sponsoring Organisations of the Treadway Commission (COSO). (2013). *Internal Control – Integrated Framework: Executive Summary.* https://na.theiia.org/standards-guidance/topics/Documents/Executive_Summary.pdf

[6] Guidance on how Charities could improve their internal controls is provided by the National Council of Social Service (NCSS); www.charities.gov.sg/Documents/Guide_on_Internal_Controls.pdf

## Box Story 1 Examples of best practices for risk management

1. Have a board of management that manages operations with an awareness of risks unique to the organisation.
2. This board of management is to identify the risk strategies suitable to the organisation and also set its risk appetite according to its size and financial position.
3. Draw up a risk profile that sets out the principal risks of the organisation and corresponding mitigating procedures, then have the profile reviewed by the Risk Management Committee for completeness and objectivity.
4. Ensure that a culture of risk awareness is developed among staff members in their day-to-day operations.
5. Consider the need for appointing a Chief Risk Officer who would, among others, develop plans to mitigate risks, monitor the progress of the risk mitigation activities, and create risk measurements and disseminate reports to the board and management.
6. Have regular management/staff meetings to increase risk awareness and discuss actual experience and actions taken to lessen the impact.

**Source: N. Subramaniam, a board member of AWWA Ltd**

for the management and avoidance of conflicts of interest, as well as related party transactions. Beyond these requirements, Charities could also include a "reserves" policy in their annual reports, and undertake a regular review of the policy and reserves levels, as this could also help them identify potential financial and operating risks.

These requirements form a baseline of the risk management procedures Charities have to possess in order to demonstrate good governance. N. Subramaniam, a board member of AWWA Ltd, shares a few examples of best practices for risk management (Box Story 1). AWWA Ltd is a local non-profit organisation that provides community-based programmes and services to people of all ages.

### RISK MANAGEMENT STRATEGY: INTERNAL CONTROLS

To further mitigate risks, the board should establish strategies to address risks through maintaining a sound system of internal controls. Internal controls refer to the checks and procedures which enable the board to meet their legal obligations to safeguard their organisation's assets and minimise the risks in administering the Charity's finances. It also aims to ensure the quality of financial reporting and compliance to laws and regulations governing Charities.

According to the Committee of Sponsoring Organisations (COSO), internal controls help "entities achieve important objectives and sustain and improve performance".[5] Having functioning internal controls is also crucial in strengthening the Charity's transparency and accountability, which are essential to draw in new volunteers and donor contributions.[6]

### INTERNAL AUDIT AS PART OF INTERNAL CONTROLS

As part of internal controls, Charities could also have internal audits to assess the Charity's current internal controls system. This would provide Charities with independent and objective assessments of the effectiveness and efficiency of their internal control procedures. With regular internal audits, the board of directors and senior management can be reassured or be made aware of the necessary steps to be taken to improve their risk management strategies.

Lilian Tay, CEO of Shared Services for Charities, provides her expert opinion on how Charities can develop effective internal controls (Box Story 2).

The "three lines of defence" model, adopted by the for-profit sector, could provide Charities with a simple way to coordinate important risk management responsibilities. Figure 1 illustrates the summarised model.

The first and second lines of defence play a crucial role in developing corresponding strategies to manage identified critical risks. Their performance is reviewed by the third line of defence, which is the internal audit. Taken together, the three lines of defence form a hierarchised organisational structure to support high standards of governance and risk management.

## CONCLUSION

Charities, by nature, exist to serve the public good. They have obligations to demonstrate high levels of ethical behaviour, transparency, accountability and compliance with the law. To do so, governing board members of Charities should ensure that they establish risk management strategies, as well as develop strong internal control policies to mitigate potential risks.

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Figure 1 The "three lines of defence" model[7]

**1st line of defence**

Managed by business units in their daily operations through appropriate internal control measures

↓

**2nd line of defence**

Handled by senior management which seeks to integrate effective risk management into processes

↓

**3rd line of defence**

Provided by the Internal Audit, which gives assurance to senior management and the board that the first and second lines' efforts align with their expectations

## Box Story 2 Risk Management advice from Lilian Tay, CEO, Shared Services for Charities

Shared Services for Charities (SSC) is a Charity for Charities that aims to improve governance and organisational excellence in non-profit organisations. SSC partners with volunteers to provide professional services in the areas of governance and internal control consultancy, policies and procedures documentation and internal audit services.

"Risk is universal and exists to threaten the achievement of objectives for Charities. Thus, regardless of the size of Charities, internal controls are necessary to mitigate risks to an acceptable level for improvement of performance and sustainability. Having secure internal controls in place would also give donors and volunteers greater confidence in Charities. Some common areas of internal control weaknesses across all the three lines of defence have been identified by Shared Services.

To begin, it is commonplace to find Charities with incomplete or obsolete policies and procedures. This may result in unwarranted risk-taking due to confusion, inconsistent practices, going beyond risk tolerance levels or even risk appetite. A lack of resources has also become the "excuse" of some of the smaller Charities for not putting proper segregation controls in place. Even so, these measures are fundamental and should not be neglected.

In order for internal controls to work effectively, it is important to set the right tone and have it resonate across the whole organisation. Moreover, to ring-fence internal control structures, a third line of defence would be required in the form of an independent review, best performed by a professional firm which has a good track record of reviewing the effectiveness of internal controls for Charities. Finally, a robust whistleblowing policy and hotline management system by an independent firm would provide added assurance."

For smaller Charities that might have not the necessary resources to deal with all identified risks, they should, nonetheless, have these risks documented in their annual reports so that the public can be made aware of such risks. These procedural checks and balances would help safeguard the finances and assets of Charities, and assist them in setting up strong governance structures to promote greater professionalism in their administration.

Accountants can volunteer their services by aiding Charities in identifying risks and developing relevant internal controls to mitigate these risks. Also, they can consider becoming honorary internal auditors to provide an independent assessment of Charities' risk, as well as to provide periodic reports to the board on findings and recommendations on their governance policies.

Another area where accountants can help Charities relates to helping them set up accounting systems to establish the full cost of providing a programme or a service. Given the limited resources available to Charities, an understanding of the full cost of the programmes and services would help them better allocate resources to the most appropriate programmes and services. Additionally, to provide Charities with a more sustainable funding model, there has been a growing call in the US and UK for funders to take into account the full cost that Charities would have to incur to carry out their programmes or provide their services. We will examine full-cost accounting in the next chapter.

[7] The Institute of Internal Auditors. (2015). *Leveraging COSO Across the Three Lines of Defense*. www.coso.org/documents/COSO-2015-3LOD-PDF.pdf

CHAPTER 5

# FULL-COST ACCOUNTING IN THE CHARITY SECTOR

Charities rely largely on donations and grants from individuals, government entities and other organisations to carry out their charitable activities. In return, Charities are expected to be accountable to their stakeholders. This chapter explores how accountants can assist Charities in developing full-cost accounting systems so they can meet numerous social demands despite their limited resources.

As explained by Gerard Ee, Chairman of the Charity Council, Singapore, "knowing the full cost of programmes will help strategic decisions to be made as to which ones to focus on and the actions required to make them sustainable". Mr Ee is also President, Institute of Singapore Chartered Accountants (ISCA).

Indeed, given that Charities operate in a rapidly-changing and competitive environment, the need for Charities to gain economic clarity around costs has become even more critical.

## WHAT IS FULL-COST ACCOUNTING?

Charities incur various types of costs when delivering their charitable programmes to advance their missions. A full-cost accounting system provides economic clarity by allocating indirect costs, in addition to direct costs, across programmes to provide a realistic picture of their full costs. This concept is elaborated in Box Story 1.

### Box Story 1 What are "full costs"?[1]

The full costs of programmes and services include both the typical direct costs as well as indirect costs incurred.

**What constitutes direct costs?**
Direct costs of programmes are incurred directly in the provision of services. As the word "direct" suggests, connecting these costs to the specific activities where they incur is straightforward.

**What constitutes indirect costs?**
Indirect costs are incurred outside the production of a particular programme or service and, as the name suggests, cannot be directly assigned to any one programme in particular.

**Consider an organisation that runs an after-school centre which offers art classes and a youth soccer programme.**

**Direct costs for art class** Materials and supplies used in the classes, the salaries of the teachers, and the snacks provided during class.

**Direct costs for soccer programme** Equipment, the salaries of the coaches and referees, and the fees for renting practice fields.

**Indirect costs** Salary and benefits of the Executive Director and other administrative staff who coordinate the centre, the rent and utilities for the centre's facility, and the printing and postage expenses for the organisation's monthly newsletter all fall into this second group of expenses.

**Why should Charities compute full costs?**
Accounting for indirect and/or overhead costs of programmes will make the cost of providing these programmes more transparent. After apportioning administrative, facility and mailing expenses for the art and soccer programmes, the organisation can gain a clearer understanding of the true costs of operating these programmes.

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[1] Colby, S. J. & Rubin, A. M. (2003). *Costs Are Cool: The Strategic Value of Economic Clarity.* https://www.bridgespan.org/insights/library/funding-strategy/costs-are-cool-the-strategic-value-of-economic-cla

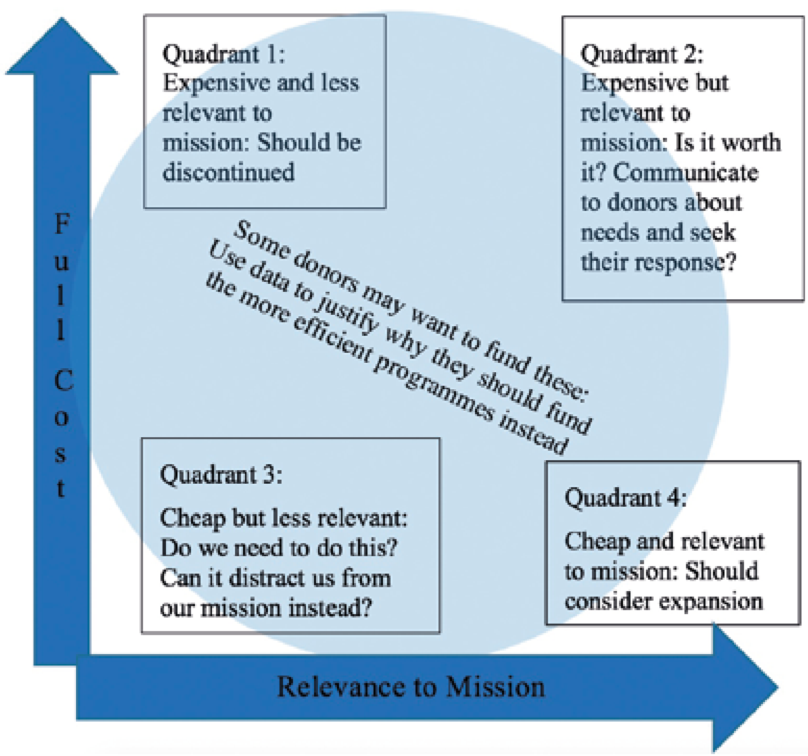
Charities would have a clearer understanding of how resources are currently being used when the full costs of programmes are computed. With this full-cost information, Charities can make, in the words of Mr Ee, better "strategic decisions… as to which ones (programmes) to focus on" and "make them (programmes) sustainable" by recovering their full costs. We will examine these benefits in the following two sections.

## FULL-COST ACCOUNTING AND RESOURCE ALLOCATION

Full-cost data allows a Charity to review each programme based on its affordability vis-à-vis its intended outcomes, and decide if scarce resources are being utilised in the most efficient manner to advance its mission. Figure 1 provides a framework that could assist Charities in identifying cost-effective programmes to make better strategic decisions in the allocation of their scarce resources. Following that, the Charity can better make decisions as to whether it should terminate (Quadrant 1), continue or perhaps even expand these programmes (Quadrant 4). In other cases, the Charity, with the knowledge of full costs, would be in a better position to consider the trade-offs between a programme that is expensive but relevant to its mission (Quadrant 2), with one that may be cheaper but less relevant (Quadrant 3).

To illustrate this, a Charity was called upon by many to expand its programme to another region, including one region that was willing to provide short-term funding. However, the Charity declined after a full-cost analysis of the programme as the analysis revealed it to be more expensive than originally believed (Quadrant 2 instead of Quadrant 4). Higher indirect costs would be incurred for the expansion as most of

Figure 1 A framework for allocating resources to programmes based on relevance to mission and full costs[2]

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such costs will have to be borne by the programme alone, rather than shared across many. Expansion would have been a drain on the programme's resources over time and therefore, an unwise strategic decision.

## FULL-COST ACCOUNTING AND SUSTAINABLE FUNDING

Charities that can communicate their full-cost information would be more transparent and accountable to stakeholders. Such information will also enable Charities to have more meaningful discussions with donors about their funding needs. With clearer information on funding needs, Charities and donors can then work towards developing a more sustainable funding model.

For a programme to be sustainable, its full cost should be fully recovered. Having economic clarity not only helps Charities to make better strategic decisions in the allocation of their scarce resources, it also allows them to have a defensible basis to justify their level of spending as well as obtain funding for their programmes based on full costs. Donors are more likely to agree if they are able to fully understand the operations and expenses (both direct and indirect) associated with these programmes.[3]

Additionally, knowledge of full costs would also assist Charities in setting the appropriate level of fees to charge beneficiaries for their various programmes. Programme fees constitute another important source of funding for Charities. Such fees allow the level of income received to be proportional to the delivery costs, creating a sustainable model that, at the very least, ensures partial cost recovery. Charging the appropriate programme fees, through a better understanding of their full cost (as opposed to charging only direct cost), will improve financial sustainability. Charities will be better equipped

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[2] Colby, S. J. & Rubin, A. M. (2003). ***Costs Are Cool: The Strategic Value of Economic Clarity***. https://www.bridgespan.org/insights/library/funding-strategy/costs-are-cool-the-strategic-value-of-economic-cla

[3] Gregory, A. G. & Howard, D. (2009). The Nonprofit Starvation Cycle. ***Stanford Social Innovation Review***. https://ssir.org/articles/entry/the_nonprofit_starvation_cycle


with the ability to provide services of greater quality.

In fact, in the United Kingdom (UK), the government is strongly promoting full-cost recovery, enabling organisations to recover the legitimate portion of overhead costs for the work they do. Otherwise, there is a danger of a Charity running into deficit and becoming unsustainable. The importance of full-cost recovery as a sustainable funding model is encapsulated in the following quote by the UK Minister for the Voluntary Sector, Fiona Mactaggart, "To build a strong, thriving voluntary sector, it cannot be living from hand to mouth."[4]

## AN APPROACH TO FULL-COST ACCOUNTING

Some US and UK Charity networks have proposed strategies to guide accountants and professionals on full-cost accounting practices for the non-profit sector. One widely-adopted approach, developed by ACEVO, the UK's leading network for Charities and social enterprise leaders, is illustrated in Figure 2.

Figure 2 Six-step process of the full-cost recovery template[5]

| | |
|---|---|
| 1 | Calculate the direct costs of the service or project. |
| 2 | Compute the overhead costs incurred by the entire organisation. |
| 3 | Allocate premises and office costs to the project, to the central functions (HR, finance, etc), and to general fundraising. |
| 4 | Allocate central function costs (now including a portion of premises and office costs) to the project, to governance and strategic development, and to general fundraising. |
| 5 | Allocate governance and strategic development costs (now including a portion of premises and office costs, and central functions costs) to the project, and to general fundraising. |
| 6 | Allocate general fundraising costs to the project if it needs to draw on fundraised income. |

The full-cost accounting approach has been lauded as a good way for Charities to make better decisions and obtain sufficient funding. Box Story 2 features a UK Charity that has benefited from the implementation of full-cost accounting.

## CHALLENGES OF IMPLEMENTING FULL-COST ACCOUNTING

Despite the benefits of adopting full-cost accounting, some Charities

[4] Aldridge, N. & Hunter, D. (2006). *Mind the gap: A funder's guide to full cost recovery.*

[5] Association of Chief Executives of Voluntary Organisations (ACEVO). (2004). *Full Cost Recovery: A guide and toolkit on cost allocation.* http://www.thinknpc.org/publications/full-cost-recovery-2/

[6] Association of Chief Executives of Voluntary Organisations (ACEVO). (2004). *Full Cost Recovery: A guide and toolkit on cost allocation.* http://www.thinknpc.org/publications/full-cost-recovery-2/

[7] Locke, S. (2014). This simple strategy tripled charity donations. *Vox.* http://www.vox.com/2014/10/30/7131345/overhead-free-donations-charity-fundraising-seed-matching-gneezy

[8] Song, U. (2014). A Funder's Message to Other Funders about Overhead. *Blue Avocado: A Magazine of American Nonprofits.* http://blueavocado.org/content/funders-message-other-funders-about-overhead

[9] Charity Council. (2015). *Inaugural Town Hall Meeting.* www.Charitycouncil.org.sg/en/Our%20Work/Events/2015/Inaugural%20Townhall%20Meeting.aspx

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may be reluctant to present the full-cost data to donors as they are afraid that donors will refuse to fund the programme if indirect costs, which do not directly translate to outcomes for beneficiaries, are too high.[7] This is in line with studies showing that some Charities understate indirect costs to obtain donations as donors may erroneously view it as a metric for efficiency.[8]

Other Charities, however, may be keen to adopt such a system but unfortunately lack the requisite skills and resources to implement it (Box Story 3). Indeed, a survey conducted in 2015 by the Charity Council identified cost accounting as one of the top three skill sets Charities in Singapore would like to improve on.[9] Hence, this presents another avenue for accountants to contribute toward building a strong and thriving Charity sector.

## CONCLUSION

Charities rely largely on donations and grants from individuals, government entities and other organisations to carry out their charitable activities. They are, however, finding themselves having to compete, increasingly, for funding to pursue their mission. As donors seek more information to make informed giving decisions, Charities could provide greater economic clarity on the full costs of their programmes, to help them better articulate their strategies and secure sustainable funding. Additionally, to cope with the uncertainty associated with their income, Charities would also need to put in place other financial policies and strategies to enhance their financial health, and better manage their cash flow on a day-to-day basis.

We will look at cash flow, investment and reserves management in the next two chapters.

### Box Story 2 Charities benefiting from Full-Cost Accounting[6]

Action on Hearing Loss (formerly known as the Royal National Institute for Deaf People) is one of the largest Charities representing the deaf and people who are hard-of-hearing in the UK. In recent years, Action on Hearing Loss has adopted ACEVO's full-cost accounting template. This has brought about the following benefits for the organisation:

1) Greater rigour and accuracy in costing programmes;
2) Improved cost-effectiveness analysis of each programme, hence enabling meaningful comparison, and
3) Using the analysis to encourage greater recognition and subsequently, acceptance, by donors to fund programmes based on their full costs so it can focus on its core mission.

According to the ACEVO report, "from such a base, negotiations over fees and funding can focus on service levels, outcomes and efficiency without being distorted by the voluntary sector subsiding statutory services".

### Box Story 3 Challenges in adopting full-cost accounting in Singapore

Locally, there are some Charities that have tried to implement full-cost accounting. Ang Chee Wee, Director of Corporate Services and Operations at the National Kidney Foundation (NKF), shares some of the challenges that the Foundation faces. NKF is a non-profit health organisation that provides medical care and support for kidney patients as well as public education for the prevention of kidney disease.

In terms of implementation costs, "I would like to think that most Charities will not have fully-computerised systems in place to help them cope with the increasing complexities of service needs. NKF faces similar challenges in getting our systems up to speed to meet with such demands," says Mr Ang. In terms of technical expertise to conduct proper allocation of indirect costs, "allocation of indirect service costings may not be able to be so specific to reflect true (or full) costings".

# CASH FLOW MANAGEMENT IN CHARITIES

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This chapter will examine the importance of good cash flow management for the sustainability of Charities' operations. Specifically, we will discuss Charities' cash flow, sources of income, their inherent income unpredictability, and approaches to overcome these challenges through forecasting and building of reserves.

## IMPORTANCE OF CASH FLOW MANAGEMENT IN CHARITIES

Charities rely on the public, corporate donors, government and other organisations for funding to carry out their charitable activities. The bulk of their funding, such as grants, donations, and income from fundraising, are not provided on a regular basis.

Due to the ad hoc nature of Charities' funding, their cash flows can be challenging to predict as they typically fluctuate throughout the year. A shortage of cash, even if temporary, is a major risk factor for Charities.[1] Therefore, Charities must pay close attention to whether they have enough

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[1] Malki, E. (2016). A Simple Model for Cash Flow Management in Nonprofits. *SSRN Electronic Journal.* https://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID2732052_code42782.pdf?abstractid=2732052&mirid=1&type=2

[2] Blackbaud. (2011). *Financial Management of Not-For-Profit Organizations.* www.blackbaud.com/files/resources/downloads/WhitePaper_FinancialManagementForNPO.pdf

[3] Sim, I., Ghoh, C., Loh, A. & Chiu, M. (2015). *The Social Service Sector in Singapore: An Exploratory Study on the Financial Characteristics of Institutions of a Public Character (IPCs) in the Social Service Sector.* Singapore: Chartered Institute of Management Accountants (CIMA) and Centre for Social Development (Asia). http://www.fas.nus.edu.sg/swk/doc/CSDA%20An%20Exploratory%20Study%20on%20the%20Financial%20Characteristics%20of%20IPCs%20in%20the%20Social%20Service%20Sector.pdf


cash reserves to be able to continually provide services to their beneficiaries,[2] while relying on incomes that are inherently unpredictable.

## CHARITIES' INCOME SOURCES

Sim, Ghoh, Loh and Chiu (2015) studied the sources of income of 202 Institutions of a Public Character (IPCs) in Singapore's Health, Social and Welfare sectors from FY 2011 to FY 2013. They found that large IPCs with total operating expenditure of S$10 million and above received the bulk of their income from government grants (around 45%), and other major sources included donations and fundraising income (around 23%), and programme income (around 21%). Whereas for IPCs with total operating expenditure of S$250,000 and below, the bulk of their income (up to 65%) came from donations and fundraising, with government grants and programme income contributing up to 20% and 12% respectively.[3] Besides income from donations and fundraising, government grants and programme fees, Charities may need to rely on income from other sources, such as investment, social enterprise and sponsorship, to cover their operating and other expenditures.

## UNPREDICTABILITY OF CHARITIES' MAJOR INCOME SOURCES

With a good understanding of the cash flow characteristics of the three major

**Charities have to run their programmes or services, even if the cost of running them cannot be defrayed. Therefore, to ensure the sustainability of the Charities' operations, there is a need for Charities to have effective cash flow management.**

income sources – donations, grants, and programme fees – accountants can help Charities develop strategies to address their cash flow challenges.

Most donors contribute to Charities on an ad hoc basis.[4] They may make pledges of support that may not be received until a later date. Some donors may reduce contributions due to changes in their business or personal circumstances. Some may attach conditions and timing restrictions on the use of the funds donated to the Charities. They may designate their contributions for specific purposes or programmes, which means that the cash might not be available to cover the recurring operating expenses, as well as other unanticipated expenditures. Charities need to understand and accept the ad hoc nature of cash flow from donors as it will affect the Charities' cash flow planning and management.

According to Dropkin (2003), grants from both government and private sources may be disbursed for general use or specific activities. Charities have to meet the requirements outlined in grant agreements, which may also affect their cash flow planning and management. However, grants may stop due to business or economic circumstances, such as policy changes. Therefore, a thorough understanding of all grant conditions is important for Charities.[5]

Programme fees are another important source of Charities' income. Charities normally charge a small fee for providing goods and services to their beneficiaries. Often, these fees do not cover the full cost of operating their programmes or services. Instead, the cost of running the programme is subsidised by the Charities' other sources of income, such as grants, donations and fundraising income, which are inherently unpredictable in nature. Charities have to run their programmes or services, even if the cost of running them cannot be defrayed. Therefore, to ensure the sustainability of the Charities' operations, there is a need for Charities to have effective cash flow management.

## EFFECTIVE CASH FLOW MANAGEMENT THROUGH FORECASTING

Good cash flow projections provide early warning system to Charities.[6] Cash flow forecasting is a projection of the Charity's future financial situation; it allows Charities to see when money is expected to be received and spent.[7] An accurate, detailed cash flow forecast, especially when used in conjunction with a detailed operating budget, will allow Charities to anticipate potential cash flow difficulties and quickly take effective remedial step.[8]

It is easier to address cash flow issues if they are anticipated early. An effective way for Charities to manage cash flow is to develop a cash flow projection for 12 months. Charities should also review and update these projections regularly. In Box Story 1, Leung Yee Ping, Executive Director, Young Women's Christian Association (YWCA) of Singapore, shares her organisation's best practices in cash flow management. Besides the development of cash flow projections, these include good governance to facilitate the visibility, as well as exercising tight control over both income and expenses.

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## BUILDING RESERVES IN CHARITIES

As a hedge against income uncertainty, Charities should build up their operating reserves to maintain their

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[4] Goy, P. (2016). Most firms give to charity but many on ad hoc basis. *The Straits Times*. www.straitstimes.com/singapore/most-firms-give-to-charity-but-many-on-ad-hoc-basis

[5] Dropkin, M. (2003, June 21). *Improving Cash Flow Management In Challenging Times: A Primer*. https://nonprofitquarterly.org/2003/06/21/improving-cash-flow-management-in-challenging-times-a-primer/

[6] Dropkin, M. (2003, June 21). *Improving Cash Flow Management In Challenging Times: A Primer*. https://nonprofitquarterly.org/2003/06/21/improving-cash-flow-management-in-challenging-times-a-primer/

[7] Hoermann, P. (2014, May 19). *Cash-flow Forecasting in Non-profit Organisations*. http://180dc.org/cash-flow-forecasting-in-non-profit-organisations-necessity-components-insights-patrick-hoermann/

[8] Dropkin, M. (2003, June 21). *Improving Cash Flow Management In Challenging Times: A Primer*. https://nonprofitquarterly.org/2003/06/21/improving-cash-flow-management-in-challenging-times-a-primer/

[9] Young Women's Christian Association of Singapore (2016). *Annual Report 2015-2016*. www.ywca.org.sg/wp-content/uploads/2016/04/YWCA-AR2016-low-res.pdf

[10] Nonprofit Operating Reserve Policy Toolkit Workgroup. (2010). *Operating Reserve Policy Toolkit for Nonprofit Organizations*. www.nccs2.org/wiki/images/d/df/Operating_Reserves_Policy_Toolkit_1st_ED_2011-07-28.pdf

[11] Barned, J. (2009). *Financial Management of Not-for-Profit Organisations*. Melbourne: CPA Australia Ltd. www.cpaaustralia.com.au/~/media/corporate/allfiles/document/professional-resources/notforprofit/financial-management-nfp-organisations.pdf?la=en

[12] Marudas, N. P. (2004). Effects of Nonprofit Organization Wealth and Efficiency on Private Donations to Large Nonprofit Organizations. *Research in Governmental and Nonprofit Accounting*, 11, 71-92

[13] Handy, F. & Webb, N. J. (2003). A Theoretical Model of the Effects of Public Funding on Saving Decisions by Charitable Nonprofit Service Providers. *Annals of Public and Cooperative Economics*, 74(2), 261-282.

[14] Calabrese, T. (2013). Running on Empty: The Operating Reserves of U.S. Nonprofit Organizations. *Nonprofit Management and Leadership*, 23(3), 281–302. www.baruch.cuny.edu/mspia/centers-and-institutes/center-for-nonprofit-strategy-and-management/documents/Calabrese_RunningonEmpty-TheOperatingReservesofUSNonprofitOrganizations.pdf

[15] Nonprofit Operating Reserve Policy Toolkit Workgroup. (2010). *Operating Reserve Policy Toolkit for Nonprofit Organizations*. www.nccs2.org/wiki/images/d/df/Operating_Reserves_Policy_Toolkit_1st_ED_2011-07-28.pdf

## Box Story 1 Best practices in cash flow management from Leung Yee Ping, Executive Director, YWCA of Singapore

Founded in 1875, the Young Women's Christian Association (YWCA) of Singapore is a large Charity with total operating expenditure of S$16.6 million in 2015.[9] YWCA is committed to providing programmes and services for women and children. Some of these include YWCA House, Workz-on-Wheels, and Empowering Mums.

**1) How does YWCA manage its cash flow?**

Based on the budget, we conduct monthly cash flow projections to ensure that income is sufficient to cover all expenditures. For any new programme, an annual cash projection is done to determine its source of funds, initial outlays, and capital and operating expenditures.

**2) Does YWCA have any best practices to share with other Charities in the sector?**

To facilitate strong cash flow management, Charities need to have:

- Budgeting with a clear financial strategy;
- Good internal controls and financial stewardship of resources, to ensure that funds are used for their intended purposes;
- A robust financial management system with timely financial reporting according to the Singapore Financial Reporting Standards. This provides accountability and transparency to all stakeholders on how resources are used and what have been achieved;
- Both the board and management should understand the financial reports so that they are aware of the expenditures incurred and state of their funds, and
- Integrity in everyone working/volunteering with the Association and strict adherence to the Conflict of Interest Policy.

financial flexibility and management of cash flow. Without an operating reserve, Charities may have difficulty responding to temporary changes in their environment or circumstances, such as delayed payments or cutbacks in funding from government agencies or donors.[10] Charities facing cash flow distress may not have the resources to continue delivery of their programmes.

There is, however, a thin line between having the right amount of cash in reserve to prevent cash flow deficits and stockpiling too much capital.[11] Many Charities argue that some donors may not want to contribute to Charities with too much accumulated wealth, as these donors may prefer to have their donations expended currently, rather than saved for subsequent fiscal years.[12] Some Charities have lower amounts of cash reserves as they anticipate that the government will provide additional financial help during difficult economic times.[13] For these reasons, some prefer to hold lower reserves to continue to attract current and future donations.[14] Unfortunately, such strategies may compromise the long-term financial sustainability of Charities. Accountants can therefore help Charities and funders to understand the importance of building sufficient reserves for their sustainability.

## CONCLUSION

For Charities to remain sustainable, good cash flow management is important. It builds public and donors' confidence, as the funds donated to the Charity will have a lasting impact.[15] In an operating environment with income unpredictability, Charities have to manage their finances well to continue providing for their beneficiaries. By building reserves, Charities will have sufficient funds to meet unexpected expenditures.

Charities are required to account for their reserves. They need to manage their reserves for the best returns, taking into account appropriate risks and donors' wishes. Accountants can help Charities with the forecasting and management of cash flow, as well as in the building of their reserves.

We will discuss Charities' reserves management in the next chapter.

# RESERVES & INVESTMENT MANAGEMENT IN CHARITIES


Charities play an important role in helping the poor, vulnerable and disadvantaged. As recommended by the Code of Governance for Charities and Institutions of a Public Character (the Code), Charities are encouraged to maintain some level of reserves to ensure their long-term financial sustainability.[1]

In this chapter, the focus of our discussion will be on the management of reserves. In Singapore, "reserves" refer to the part of the Charities' income funds that is freely available for its operating purposes and is not subject to commitments, planned expenditure and spending limits.[2] The areas of discussion, in this article, will include (1) disclosure of reserves policy, (2) factors to consider in setting the appropriate level of reserves, as well as (3) investment management of reserves.

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[1] Charity Council. (2011). *Code of Governance for Charities and IPCs*; www.charities.gov.sg/Documents/Code_of_Governance_for_Charities_and_IPCs_%28English%29.pdf

[2] Charity portal. (2014). *Accounting Glossary for Charities and IPCs*; www.charities.gov.sg/Documents/Accounting_Glossary.pdf

[3] Charity Council. (2011). *Code of Governance for Charities and IPCs*; www.charities.gov.sg/Documents/Code_of_Governance_for_Charities_and_IPCs_%28English%29.pdf

[4] Nonprofits Assistance Fund. (2014). *Nonprofit Operating Reserves and Policy Examples*; https://nonprofitsassistancefund.org/sites/naf-prod/files/publications/nonprofit_operating_reserves_and_policy_examples_2014.pdf

[5]Sim, I., Ghoh, C., Loh, A. & Chiu, M. (2015). *The Social Service Sector in Singapore: An Exploratory Study on the Financial Characteristics of Institutions of a Public Character (IPCs) in the Social Service Sector*. Singapore: Chartered Institute of Management Accountants (CIMA) and Centre for Social Development (Asia). http://www.fas.nus.edu.sg/swk/doc/CSDA%20An%20Exploratory%20Study%20on%20the%20Financial%20Characteristics%20of%20IPCs%20in%20the%20Social%20Service%20Sector.pdf

[6] National Council of Social Service. (2008). *Reserves Policy Guide for Charities*. www.charities.gov.sg/Documents/Reserves_Policy_Guide.doc


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## DISCLOSURE OF RESERVES POLICY

As recommended by the Code, Charities are encouraged to disclose their reserves policy in their annual reports.[3] The reserves policy will help Charities to define and set goals for reserve funds, clearly describe the authorisation for the use of reserves, and outline requirements for reporting and monitoring. Without a reserves policy, Charities may run a risk of having funds gradually depleting over time and not being available when they need the funds.[4]

## HOW MUCH RESERVES SHOULD CHARITIES MAINTAIN?

There is no consensus among Charities as to the appropriate level of reserves to maintain. Based on a 2015 social service sector study on 202 IPCs in the Health and Social Welfare sectors, the IPCs were found to normally maintain surpluses in their reserves that amount to about two years of the Charities' annual operating budget.[5]

The National Council of Social Service (NCSS) Reserves Policy Guide recommends that Charities should carry out thorough analyses of income and expenditures, risk profiles as well as past and future financial trends to develop their own reserves policy.[6] Some examples of risk factors, as indicated by the Nonprofit Operating Reserve Policy Toolkit Workgroup,

**Accountants could help Charities conduct a thorough review on whether it has maintained a sufficient level of reserves to ensure its sustainability, as well as in developing a reserves policy to govern the use of reserves.**


include (1) the stability of donated revenue from primary sources; (2) the level of dependence on one or two major income sources, and (3) the extent to which economic downturns or other events may affect demand for services[7], among others. Accountants could help Charities conduct a thorough review on whether it has maintained a sufficient level of reserves to ensure its sustainability, as well as in developing a reserves policy to govern the use of reserves.

Charities may consider the following guidelines when developing an appropriate reserves policy (Table 1).

Besides developing a justifiable reserves policy for sustainability, Charities can potentially make their reserves work harder through the investment of their reserves.

## INVESTMENT OF RESERVES

Many Charities, however, adopt a conservative attitude when it comes to reserves. Rather than viewing them as an asset that needs to be actively managed, reserves are often seen as a resource that should be protected and preserved.[8]

In the United Kingdom, there is detailed legislation to ensure that trustees of Charities have overall responsibilities for investment of a Charity's funds. These include the need to draw on expertise, pick an appropriate investment class, and consider diversification to reduce their risk exposure.[10]

In Singapore, guidelines for investment management in Charities are provided by both the Office of the Commissioner of Charities (COC) and the Charity Council via the Guidance for Charities Engaging in Business Activities and the Code respectively. It is recommended that Charities:

1) Must not be distracted from its core charitable purposes[11];
2) Have to take into full account the

Table 1 Guidelines on Developing a Reserves Policy[9]

| | |
|---|---|
| 1 | **Purpose of building and maintaining reserves;** |
| 2 | **Definitions of the types of reserves, intended use, and calculation of target amounts;** |
| 3 | **Assignment of authority for making use of each type of reserve fund, which may include delegation of some authority to staff leaders;** |
| 4 | **Responsibilities for reporting reserve fund amounts, and** |
| 5 | **Any specific policies, if needed, about investment of reserve funds.** |

[7] Nonprofit Operating Reserve Policy Toolkit Workgroup. (2010). *Operating Reserve Policy Toolkit for Nonprofit Organizations.* www.nccs2.org/wiki/images/d/df/Operating_Reserves_Policy_Toolkit_1st_ED_2011-07-28.pdf

[8] Association of Chief Executives of Voluntary Organisations (ACEVO). (2012). *Beyond Reserves.* http://www.sayervincent.co.uk/wp-content/uploads/2015/07/BeyondReserves.pdf

[9] Nonprofits Assistance Fund. (2014). *Nonprofit Operating Reserves and Policy Examples.* https://nonprofitsassistancefund.org/sites/naf-prod/files/publications/nonprofit_operating_reserves_and_policy_examples_2014.pdf

[10] Charity Commission for England and Wales. (2016, August 1). *Charities and investment matters: a guide for trustees.* www.gov.uk/government/publications/charities-and-investment-matters-a-guide-for-trustees-cc14/charities-and-investment-matters-a-guide-for-trustees

[11] Commissioner of Charities. (2016). *Guidance For Charities Engaging in Business Activities. www.charities.gov.sg/*manage-your-charity/Consideration%20as%20your%20charity%20expand/Pages/Guidance%20on%20Charities%20Engaging%20in%20Business%20Activities.aspx

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potential risks and returns, and must not expose its charitable assets to significant risk[12];

3) Have their investment policy approved by their Board[13];
4) Have their Board ensure transparency in its investments[14], and
5) Obtain advice from qualified professional advisors if deemed necessary by their Board.[15]

## Box Story 1 Investment management policy and challenges in investment management, as shared by Edmund Wan, President of HWA

Handicaps Welfare Association (HWA) was founded in 1969 to promote self-help and offer a platform for mutual support among the disabled in Singapore. With a total operating expenditure of S$6 million in 2016[16], HWA is a large Charity run by people with disabilities, for people with disabilities.

**What is your investment management policy?**
Our reserves are not much to warrant the need for an investment management team. Additionally, donors and stakeholders are not so forgiving if there is a possibility of our investment being a failure. Hence, we have a low risk appetite and invest in time or fixed deposits, even though the returns are not much when compared to the rising cost of living.

**What are the challenges which Charities face regarding investment management?**
Charities should ensure that they have the required expertise in managing investment, which, unfortunately, some may not have.

Charities which do not have much reserves should also not "gamble" on investments as setbacks can bring about their downfall. In this regard, small Charities have advocated for fund managers, financial institutions or even the NCSS to provide "Capital Protection Investments". This ensures that the sum invested is high, and receive higher returns than from fixed deposits.

Finally, investments should also be in appropriate amounts as premature withdrawals from long-term investments due to cash flow issues may work negatively on them.

While there is a growing call for Charities to actively manage their reserves, unfortunately, many do not have the expertise to do so, and are inclined to put their reserves in fixed deposits, given their low risk appetite. In Box Story 1, Edmund Wan, President of the Handicaps Welfare Association (HWA), echoes this sentiment and offers more insights into the investment challenges faced by Charities.

To address these challenges, accountants, together with investment professionals, can help advise Charities on an investment policy to determine the amount to invest at a risk level acceptable to stakeholders.

## CONCLUSION

In this chapter, we have explored how accountants can help Charities understand how reserves can be better utilised. To do so, Charities must balance the need to manage risks against the need to serve beneficiaries effectively. To achieve this balance, Charities need to have a good understanding of the financial strategy and investment model together with the risks inherent in the model. Whatever decision Charities make about reserves, they should ensure that it was arrived at after careful deliberation, made as part of the Charities' strategic planning, and with the recognition that reserves are a resource to be managed and utilised to meet the needs of beneficiaries.[17] Given the expertise and skills accountants have, they can play a significant role in helping to develop a strong and sustainable Charity sector. Accountants can certainly do good by helping Charities to do good better.

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# CONCLUSION

Charities need to develop public trust to continue getting support for donations and sponsorship. To obtain this trust, they must be accountable. In addition to meeting their goals and fulfilling their mission, Charities should be able to manage their accounts and their finances competently. Many Charities however, especially smaller ones, cannot measure up. The main reason is that they lack the skills and resources to develop the necessary processes, procedures, and systems. By virtue of their training and experience, accountants can help Charities to do better. This book has identified and discussed some key areas where accountants can help raise the standards of governance and financial management. These are listed below.

Areas where accountants can help:

- Keeping proper accounts
- Drawing up a proper budget
- Preparing cash flows
- Implementing a full-cost accounting system
- Ensuring adequate amounts of reserves are in place
- Adopting a suitable investment strategy, together with investment professionals
- Conducting risk management
- Designing internal controls to mitigate these risks
- Complying with the Code of Governance for Charities
- Adopting the Charities Accounting Standard
- Conducting internal audits

We hope that board members and the management of Charities will also benefit from reading this book. It can help them to identify where their Charities have fallen short and to seek help from volunteer accountants where needed.

# WANT TO HELP?

If you are an accountant and you wish to volunteer your services, you can contact ISCA Cares at isca@isca.org.sg. More information on ISCA Cares is provided on page 58 of this book, and at http://isca.org.sg/isca-cares.

If you are a Charity and would like to find out about programmes organised by the National Volunteer & Philanthropy Centre (NVPC), you can contact NVPC at feedback@nvpc.org.sg. More information on NVPC is provided on page 58 of this book and at https://www.nvpc.org.sg/home.

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## ABOUT CSDA

The Centre for Social Development Asia (CSDA) was launched in July 2007 by then Minister for Finance Mr Tharman Shanmugaratnam. It is under the purview of the Department of Social Work, Faculty of Arts and Social Sciences, National University of Singapore. The Centre was established in collaboration with the Centre for Social Development, George Warren Brown School of Social Work, Washington University in St Louis. The primary mission of CSDA is applied research and knowledge building to inform policies and programmes in social development, with a focus on Asia.

For more information about CSDA, please visit http://www.fas.nus.edu.sg/swk/partners_and_donors/research_partner/overview.

## ABOUT DEPARTMENT OF SOCIAL WORK

Social Work as a subject in the University first started in 1952, when it offered the first professional social work qualification in Singapore – the two-year Diploma in Social Studies of the Department of Social Work, at the then Singapore University. Since then, the department has evolved with the changing times, circumstances and requirements of the country into its present form. The department's vision is to be a leading educational and research institution within the international social work community, providing a distinctive Asian perspective in social work and social development.

For more information about the Department of Social Work, please visit http://www.fas.nus.edu.sg/swk/.

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ISCA INSTITUTE OF SINGAPORE CHARTERED ACCOUNTANTS

## ABOUT ISCA

The Institute of Singapore Chartered Accountants (ISCA) is the national accountancy body of Singapore. ISCA's vision is to be a globally recognised professional accountancy body, bringing value to our members, the profession and wider community. There are over 30,000 ISCA members making their stride in businesses across industries in Singapore and around the world.

Established in 1963, ISCA is an advocate of the interests of the profession. Possessing a Global Mindset, with Asian Insights, ISCA leverages its regional expertise, knowledge, and networks with diverse stakeholders to contribute towards Singapore's transformation into a global accountancy hub.

ISCA is the Administrator of the Singapore CA Qualification and the Designated Entity to confer the Chartered Accountant of Singapore – CA (Singapore) – designation.

ISCA is an Associate of Chartered Accountants Worldwide – supporting, developing and promoting over 640,000 Chartered Accountants in more than 200 countries around the world.

For more information, visit www.isca.org.sg.

CHARITY COUNCIL

## ABOUT CHARITY COUNCIL

The Charity Council aims to promote and encourage the adoption of good governance and best practices, to help enhance public confidence and promote self-regulation in the charity sector. It also aims to help build capabilities of charities and IPCs to enable them to comply with regulatory requirements and enhance public accountability. In addition, the Council advises the Commissioner of Charities (COC) on key regulatory issues such as proposals on new regulations, where there may be broad-ranging impact on charities and IPCs.

The Council comprises of 15 members, including the Chairman. Ten members are from the people sector, chosen for their expertise in accountancy, corporate governance, entrepreneurship, media and law. They are also involved in volunteer and charity work in varied fields such as arts and heritage, community, education, health and social services.

For more information about the Charity Council and its initiatives, please visit https://www.charitycouncil.org.sg/.

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CIMA Chartered Institute of Management Accountants

## ABOUT CIMA

The Chartered Institute of Management Accountants (CIMA), founded in 1919, is the world's leading and largest professional body of management accountants, with over 232,000 members and students operating in 177 countries, working at the heart of business. CIMA members and students work in industry, commerce, the public sector and not-for-profit organisations. CIMA works closely with employers and sponsors leading-edge research, constantly updating its qualification, professional experience requirements and continuing professional development to ensure it remains the employers' choice when recruiting financially-trained business leaders.

Professionalism and ethics are at the core of CIMA's activities with every member and student bound by robust standards so that integrity, expertise and vision are brought together.

Together with the American Institute of CPAs (AICPA) CIMA has established the Chartered Global Management Accountant (CGMA) designation. CGMA is the global quality standard that further elevates the profession of management accounting. The designation recognises the most talented and committed management accountants with the discipline and skill to drive strong business performance.

The AICPA and CIMA also make up the Association of International Certified Professional Accountants (the Association), which represents public and management accounting globally, advocating on behalf the public interest and advancing the quality, competency and employability of CPAs, CGMAs and other accounting and finance professionals worldwide.

For more information about CIMA, please visit www.cimaglobal.com.
Follow us on Twitter at www.twitter.com/CIMA_News.

## ABOUT ISCA CARES

ISCA Cares is the charity arm of the Institute of Singapore Chartered Accountants (ISCA) set up in 2015, as part of Singapore's SG50 celebration.

ISCA Cares envisions a compassionate and caring accountancy community that actively contributes towards the betterment of society. Its mission is to encourage open-heartedness by promoting a strong social conscience and a spirit of inclusivity in the accountancy community.

ISCA Cares supports two charitable causes:

**Education:** To provide needy Singapore youths with academic potential access to quality accountancy education through financial and non-financial assistance.

**Community:** To harness the knowledge, skills and expertise of the accountancy community, for community development projects through collaborative programmes with partners.

To find out more about ISCA Cares, please visit iscacares.org.sg.

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## ABOUT NVPC

The National Volunteer & Philanthropy Centre (NVPC) is a non-profit organisation promoting a giving culture in Singapore. We are the nation's leading connector of volunteers and donors with giving opportunities, facilitating partnerships with non-profits, companies, public sector bodies and individuals so that they may embark on or deepen their giving journey.

We promote volunteerism through our Giving Initiatives:

**1) Centre for Non-Profit Leadership (CNPL)**
Through CNPL's PeopleSearch programmes, we recruit volunteers to be placed as board or committee members in other non-profits.

**2) Company of Good (COG): A Community of Givers**
COG looks to ignite the corporate giving movement by enhancing capability, advocacy and facilitating giving opportunities for businesses.

**3) Giving.sg: Our National Giving Platform**
Giving.sg is Singapore's one-stop giving platform, where anyone can donate, volunteer or fundraise for a charity of their choice.

**4) Giving Week: Building A City of Good**
During Giving Week (28 Nov to 5 Dec 2017), corporates, non-profits and individuals come together to make a difference by donating, volunteering, fundraising or attending a festival event.

**5) SG Cares Movement**
Together with NCSS, NVPC is co-leading SG Cares Movement, a national movement dedicated to fostering a caring and inclusive home.

To find out more about the volunteering opportunities, please visit https://www.giving.sg.

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