Booklet 4 of 5

Accounting and Finance Handbooks for Charities

Reserves and Investment

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About the Handbook

This handbook consists of a series of five booklets, each covering key accounting practices relevant to the charity sector. It deals, specifically, with the following: budgeting and cash flow management, fund accounting, full cost recovery, reserves and investments, and cost-effective audit for charities.

It is hoped that Board members, management, and staff of charities, especially those without financial training, will find this handbook easy to read and a useful reference to enhance their financial operations. This in turn will lead to greater transparency and accountability of charities to the public.

The content is developed with the charities and for the charities. Each booklet is written by professional accountants who are experts in their fields. To provide practical insights, the content incorporates applied examples as well as interviews with local charities.

The editors have sought to preserve the content contributed by the authors and interviewees as far as possible. The content has been reviewed by practitioners in the industry.

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Foreword

Centre for Social Development Asia (CSDA)

Dr S. Vasoo
Chairman
Centre for Social Development Asia
Department of Social Work
Faculty of Arts and Social Sciences
National University of Singapore

Corporate governance and public accountability of charities are critical as mismanagement can have serious ramifications to their viability. The Centre for Social Development Asia (CSDA) is indeed appreciative of the support by Chartered Institute of Management Accountants (CIMA) for the publication of the 'Accounting and Finance Handbooks for Charities'.

As part of good governance, charities need to adopt sound accounting and finance practices to remain viable in the long term. This handbook serves as a manual that guides the Board and Management of the charities, to widen their knowledge on how to implement and monitor financial practices in their organisations.

Board members can refer to this handbook to better understand the diverse facets of financial management, and use the templates provided within to better implement accounting practices. Charities can also use this handbook as a training manual for their staff. It is envisioned that the Accounting and Finance Handbook for Charities will be helpful to all involved in understanding and implementing accounting and finance practices for charities. It will be encouraging to see further attempts by various Boards and Managements to improve the corporate governance arena of charities.

Lastly, we are grateful to the authors, academic staff, peer-reviewers, charities, and interns who worked tirelessly to make this valuable publication possible.

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

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

Foreword

Chartered Institute of Management Accountants (CIMA)

Dr Noel Tagoe
FCMA, CGMA
Executive Vice President, Academics
Chartered Institute of Management Accountants

Philanthropic activities are proving to be more challenging as technology becomes the key driver behind the drastic changes on economic and social landscapes. It would be fair to say that furthering the cause to create a sustainable business model for charities has gradually become more pertinent, especially in this time and age.

Good governance is difficult to come by. To deliver service effectively to their beneficiaries, it is crucial to support charities with strong governance, coupled with robust structures, processes and good behaviour. Ensuring that good management accounting practices are in place, coupled with the ability to analyse and formulate the programmes, will help create stakeholder value. Transparency and accountability accompanied with good disclosure practices in financial management will give confidence to donors that the funds that they have contributed are doing good for society.

CIMA Centre of Excellence would like to take this opportunity to commend CSDA for its philanthropic approach to help charities do good better. We applaud CSDA for this timely publication to build a stronger charity sector in Singapore, and we commend their great efforts in the successful release of this book on charity governance.

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 qualifications, professional experience requirements and continuing professional development to ensure it remains the employers' choice when recruiting financially-trained business leaders.

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 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.

Foreword

Charity Council

Dr Gerard Ee
FCA (Singapore)
Chairman
Charity Council

Charities must be good stewards of the donations they are entrusted with and ensure that resources are used for the purpose intended. Hence, having sound financial management practices is essential to the sustainability and success of the charity. This handbook is written in an easy to understand manner, to aid charities in their implementation of financial practices.

I encourage charities to fully utilise this handbook and would like to thank the authors and charities which have contributed their invaluable time and expertise to this book. I look forward to seeing the sector being equipped with more governance knowledge and relevant skill sets.

About Charity Council

The Charity Council aims to promote and encourage the adoption of good governance standards and best practices, to help enhance public confidence and promote self-regulation in the charity sector. It also helps to build governance capabilities of charities to enable them to comply with regulatory requirements and be more accountable.

The Council comprises of 15 members, including the Chairman. 10 members are from the people sector, chosen for their expertise in accountancy, corporate governance, entrepreneurship 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.

Foreword

The Commissioner of Charities

Adjunct Professor Ang Hak Seng
Commissioner of Charities

Charities perform a multitude of good works and play a vital role in society. Not only do they serve people and communities in need, charities also spur a caring and giving culture in Singapore.

With all the good done, it is important for charities to be accountable to their stakeholders, so as to build and sustain public trust and confidence. It is crucial for charities to embrace and apply good governance practices to ensure that charitable assets and monies are well protected, managed, and accounted for.

I commend the authors and charities who have shown their collective commitment in sharing knowledge and insights to steer and support charity accounting and reporting – it is indeed a collaborative effort towards our vision of a well-governed and thriving charity sector with strong public support.

About The Commissioner of Charities

The Commissioner of Charities oversees the charities and Institutions of a Public Character (IPCs) in the charity sector, with the assistance of 5 Sector Administrators from the Ministry of Social and Family Development, Ministry of Education, Ministry of Health, People's Association and Sport Singapore. Its vision is to develop a well-governed and thriving charity sector with strong public support.

The objectives of the Commissioner as stated in the Charities Act are:

- To maintain public trust and confidence in charities;
- To promote compliance by governing board members and key officers with their legal obligations in exercising control and management of the administration of their charities;
- To promote the effective use of charitable resources; and
- To enhance the accountability of charities to donors, beneficiaries and the general public.

Foreword

CFA Society Singapore

Ms Tan Lay Hoon
President
CFA Society Singapore

In a 2015 survey conducted by the Charity Council, charities have indicated that one of the top priorities where they need help is in financial management. Hence, it gives us immense pleasure to be part of this handbook project.

We hope that this handbook serves as a reference to Board members and staff of charities and while the booklet may serve as a guide, it will not be easy for charities to get started without any professional help.

CFA Society Singapore is a member society of CFA Institute, a global association of investment professionals with a mission to lead the investment profession by promoting the highest standards of ethics, education and professional excellence for the ultimate benefit of society. It is our privilege if our members are able to contribute and give back for the benefit of society.

About CFA Society Singapore

Established in September 1987, CFA Society Singapore (formerly known as the Singapore Society of Financial Analysts-SSFA) is a professional society that brings together practitioners in the investment and fund management industry in Singapore. Its principal objective is to promote and uphold professional standards and ethical practice in financial analysis and investment management in Singapore. CFA Society Singapore is the 7th largest Member Society of CFA Institute, with more than 3,600 members.

The Society runs a whole host of programmes for members, CFA candidates and also the investment community, including Professional Development talks and seminars, Networking sessions, CFA information sessions and examination review classes, and Career Development talks.

Foreword

Baker Tilly

Mr Sim Guan Seng
FCA (Singapore), CIA
Managing Partner
Baker Tilly

Good financial reporting and sound financial management are key pillars of charity governance. As stewards of donors, not only do charities have to ensure that a proper account is given of how donations received are used in order to maintain public trust, they also have to ensure that funds received are utilised in the most effective and efficient manner.

Keeping in mind that accounting and financial management practices in the charity sector may differ from those in the business world, I am greatly heartened by the timely introduction of this Accounting and Finance Handbook for Charities. This handbook, with its many best practices and recommendations, will be a good resource for Board members and management of charities.

I commend CSDA for initiating the publishing of this handbook. I am pleased that my partner, Susan Foong, was able to play a part by contributing to the writing of the fund accounting booklet in the handbook. The fund accounting booklet closes the knowledge gap in accounting practices of charities in Singapore.

About Baker Tilly

Baker Tilly's origins can be traced back to 1985 when Teo, Foong + Wong was founded. Transitional, historical name changes and mergers with various firms have brought Baker Tilly to where it is today. The firm joined the Baker Tilly International network in 2005. This long history gives Baker Tilly a rich heritage and defines the firm's present.

Since 1985, the firm has specialised in serving charities and not-for-profit organisations. Baker Tilly's extensive experience and understanding of the charity sector enables the firm to provide quality service to support its clients in their pursuit to do good works. Partners and teams in the firm have in-depth knowledge of the regulations and developments in the charity sector. More importantly, because of the firm's long history of serving charities, teams in the firm also understand the ethos and values of charity clients.

Baker Tilly services include assurance, tax, deal advisory, governance and risk, restructuring and recovery, outsourcing, and corporate secretarial. Baker Tilly is an independent member of Baker Tilly International, one of the world's 10 largest accounting and business advisory network. With this network, clients have access to global leaders in every area of business expertise.

The firm posts regular articles of interest to charities in The Salient Point, Baker Tilly's newsletter. To read these articles or to learn more about the firm's services, visit **www.bakertilly.sg.**

Foreword

RSM

Mr Kaka Singh

FCA, FCCA, FCIS, FCMA, FCPA, CA
Chairman and Senior Partner
RSM

The Accounting and Finance Handbook for Charities is a commendable initiative by CSDA as it examines and compiles multiple facets of accounting and finance practices. In simple language, it provides examples of good practices and demonstrates where collective action by charities, regulators and auditors is beneficial to all and will prove vital to the continued, successful delivery of services by charities.

This handbook also guides Board members and management in effective financial monitoring of their operations and in receiving timely, relevant and accurate information frequently enough to understand when things are on track or whether emerging concerns need to be addressed.

I am pleased that our Not-for-Profit Organisation (NPO) Practice Head, Woo E-Sah, was given the opportunity to contribute to this handbook. I also encourage all charities to tap into this informative resource to enhance their financial operations.

About RSM

RSM is the sixth largest audit, tax and consulting network globally. In Singapore, the firm is the largest outside the Big 4, serving internationally active businesses.

It focuses on growing businesses, helping them to improve profits, enhance business value and internationalise.

RSM provides audit, tax, corporate and risk advisory, as well as business support services.

Its dedicated NPO Practice Team works with numerous clients—including large societies and companies limited by guarantee—across diverse sectors, offering them the added advantages of:

- Expertise in the Singapore Financial Reporting Standards, the Charities Accounting Standard, and the Code of Governance for Charities and IPCs;
- High partner, director and manager involvement;
- End-to-end services and capabilities; and
- Expertise in compliance with legislation governing charities and IPCs.

Reserves and Investment

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Author's Acknowledgement

Reserves and Investment

Charity governance is of key importance to the social service sector. It has been my pleasure to participate in the Accounting and Finance Handbooks for Charities, and to contribute to the Reserves and Investment booklet.

In this booklet, I have strived to adapt my accounting and finance skills, experience, and knowledge for the nonprofit sector. I hope that the staff, management, and Boards of the various charities in Singapore will find this booklet helpful as a guide in their management of reserves and investment.

I would like to thank many individuals and organisations for their invaluable contribution to this project. Firstly, a huge thank you to my colleagues, Professor Alfred Loh and Professor Teo Chee Khiang, for working on this project tirelessly. I would also like to extend my gratitude to Professor Corinne Ghoh, Dr S. Vasoo, Ms Joanne Liang, Ms Tan Shi Hui, and the Department of Social Work for their support. This project would not have been possible without financial support from our generous sponsors: CIMA, CFA Society Singapore, Baker Tilly, and RSM. Last but not least, a big thank you to the 53 dedicated NUS students who interned at CSDA!

ABOUT THE AUTHOR

Dr Isabel Sim is currently a Senior Research Fellow at the Department of Social Work, National University of Singapore. She is also the Director of Projects at Centre for Social Development Asia. Prior to these appointments, she held a joint appointment at NUS Business School as Senior Lecturer at the Department of Strategy and Policy, and Senior Research Fellow at the Centre of Governance, Institutions and Organisations (CGIO). Isabel also previously served as the principal consultant for Singapore's Governance and Transparency Index (GTI) and sat on corporate governance experts' panel to the ASEAN Corporate Governance Scorecard.

Author's Acknowledgement

Reserves and Investment

I am humbled and honoured to be invited by CSDA to contribute to this book project on reserves and investments in my capacity as Deputy President of CFA Society Singapore.

I would like to thank CFA for its generosity in contributing to the sponsorship of this handbook project. I am grateful for this opportunity to work with my co-author and editor of this handbook series, Dr Isabel Sim. I would also like to extend my thanks to Professor Alfred and Professor Teo for their contribution to this project.

Lastly, I would like to thank the interns of CSDA who have assisted the project tirelessly.

ABOUT THE AUTHOR

Simon Ng is the Deputy President of CFA Singapore Society and an Independent Director of Arts Theatre of Singapore Ltd. He joined CCB International (Singapore) Pte. Ltd. in 2016 as CEO/Managing Director after leaving Shanda Group, a private investment holding company with US$8 billion Asset under Management where he headed Multi-Asset Investment activities. Prior to Shanda Group, Simon was the Pan Asia Deputy Chief Investment Officer of AXA Rosenberg Investment Management.

CHAPTER 1
Introduction

Charities are important in helping the disadvantaged and vulnerable groups in society. Therefore, it is recommended that charities maintain some level of reserves to ensure their long-term financial sustainability (Sim, Loh & Teo, 2017).

Setting the levels of reserves a charity needs is an important part of financial management and forward financial planning. Reserve levels that are too high may limit the amount spent on charitable activities. On the other hand, reserve levels that are too low make it difficult for the charity to continue operating in the future. To ensure that charities have an appropriate level of reserves, trustees[1] need to regularly monitor management accounts and cashflow (Ediss, 2017).

Developing a reserves policy should be part of a charity's financial planning, budgeting and risk management process. For a charity to adapt to changes, it needs a well-thought out reserves policy. There are several approaches that a charity can use to develop a reserves policy. While there is no fixed level of reserves a charity should hold, each charity should develop its own policy and procedures for reserves and investment management based on the organisation's needs. The reserve level is not static, and should be reviewed and updated when circumstances change (Ediss, 2017).

This handbook is written with the Board and management of social service organisations (SSOrgs) in mind. A social service organisation is a nonprofit organisation that provides services to benefit the community (National Council of Social Service, 2019). The use of the terms 'charities' and 'SSOrgs' will be used interchangeably. This handbook seeks to provide guidance to charities on reserves and investment practices to help them be more sustainable in the long run. Technical jargons have been kept to a minimum and will be explained to facilitate ease of understanding.

Chapters 2 to 4 document the reserves and investment practices among charities in Singapore. Using examples from other countries, Chapters 5 and 6 highlight the importance of accountability and provide the best practices in the area of reserves management and investment. The main references from overseas are from the Association of Chief Executives of Voluntary Organisations (ACEVO) and the Charity Commission of England and Wales (CCEW) from the United Kingdom, as well as the CFA Institute and the National Center for Charitable Statistics (NCCS) based in the USA.

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[1] Trustees and Board members are used interchangeably in this publication.

CHAPTER 2
Charities in Singapore

This chapter provides an overview of Singapore's charity landscapes, legislations, and key voluntary guidelines for charities. It is important for the Board and management of SSOrgs to have a clear understanding of the local requirements and practices of the charity sector.

2.1 Overview of the Charity Sector

According to the Charity Portal (n.d.-b), a charity is an organisation that "operates on a non-profit basis; [is] set up exclusively for charitable purposes; and [carries] out activities to achieve these purposes which benefit the public". Examples of charitable purposes include relief of poverty, advancement of education, advancement of religion, and other purposes beneficial to the community.

In Singapore, the government encourages community-based and community-led initiatives. In this framework, government bodies, enablers, grantmakers, donors, volunteers, and SSOrgs work together to provide social assistance to the poor, vulnerable and disadvantaged (Sim, Loh & Teo, 2017). Charities are required by law to register with the Office of Commissioner of Charities (COC). Some charities are conferred the status of an Institution of a Public Character (IPC). These charities are able to issue tax deductible receipts for qualified donations, allowing them to attract more donations. However, as a result, IPCs are held to more stringent regulatory standards than normal charities (Charity Portal, n.d.-b).

The government plays an important role in supporting the development of the charity sector in Singapore. All registered charities, including IPCs, enjoy income and property tax exemption on premises used exclusively for charitable purposes (Sim, Menon, Loh & Hoe, 2016).

The number of registered charities in Singapore have been increasingly steadily. In 2016, the total number of charities registered in Singapore was 2,247. Registered charities and IPCs are classified into different sectors according to the charitable purpose they serve. These sectors include Sports, Community, Education, Health, Arts and Heritage, Social and Welfare, Religious, and Others. In 2017, 48.2% of IPCs were in the Social and Welfare, and the Healthcare sectors (Sim, Loh, Tay & Hoe, 2017). The aim of this handbook is to provide guidance on reserves and investment management for the Social and Welfare and Healthcare sectors.

2.2 Legislation and Key Guidelines for Charities

Charities need to be accountable to the public. To this end, charities in Singapore have to comply with key governance legislations and are encouraged to follow guidelines. Key legislations and guidelines include the Charities Act, The Code of Governance for Charities and IPCs which was revised in 2017, hereafter referred to as 'The Code' (2017), the Governance Evaluation Checklist (GEC) and the Charity Transparency Framework. Details on the key legislations and guidelines are provided in the table below.

Table 1: Overview of Key Legislation for Charities in Singapore

Legislation	Overview
The Charities Act *Available at: https://sso.agc.gov.sg/Act/CA1994*	The Act makes provisions for the registration of charities, the administration of the charities and their affairs, and also for the regulation of charities and IPCs.
The Code of Governance for Charities and IPCs (The Code) *Available at: http://bit.ly/charitycode*	The Code sets out principles and best practices in key areas of governance and management that charities are encouraged to adopt to be more effective and accountable. The Code should be read in conjunction with the Charities Act and Regulations.
The Governance Evaluation Checklist *Available at: http://bit.ly/charitygec*	The checklist is designed to help charities and IPCs conduct a self-evaluation on the extent to which they have complied with the essential guidelines found in The Code. Charities with gross annual receipts or total expenditures, of more than S$50,000 (whichever is higher) and all IPCs are required to submit their GECs to their respective sector administrators via the Charity Portal, within six months after the end of each financial year.
The Charity Transparency Framework *Available at: http://bit.ly/charityframework*	A set of guidelines for self-assessment designed to help charities enhance their accountability and transparency, in addition to the implementation of good governance practices.

As specified in The Code, governance is important because it affects how a charity is run. To manage the organisation's overall direction, effectiveness, supervision and accountability, the Board and Management needs to understand and comply with governance requirements set out in the key legislation and guidelines. By complying with relevant legislative requirements, the public is assured of the organisation's ability to maintain good governance.

All charities should go through The Code and take the necessary actions to improve their governance. However, as charities differ in size and activity, not all guidelines will apply to every charity. The Code guidelines are applicable depending on the size of the charity and its IPC status.

Based on The Code, charities in Singapore are categorised into tiers based on their total expenditure or gross annual receipts. There are four different tiers: Basic, Intermediate, Enhanced, and Advanced. The definition and details of each category of the charity can be found in *Table 2.*

Table 2: Charity Tiers

Charity Size (by gross annual receipts or total expenditure)*	Tier (Charity)	Tier (IPC)
S$50,000 to less than S$500,000	Basic	Intermediate
S$500,000 to less than S$10 million	Intermediate	Enhanced
S$10 million or more	Enhanced	Advanced

*Gross annual receipts include all income, grants, donations, sponsorships and all other receipts of any kind. Total expenditure encompasses all costs of generating funds, costs of charitable activities, governance costs and other expenditures as reflected in the unrestricted funds, restricted income funds and endowment funds.

Note:

Adapted from The Code of Governance for Charities and Institutions of a Public Character (2017).Retrieved from https://www.charities.gov.sg/manage-your-charity/Day-to-Day-Operations-of-Charity-IPC/Documents/Code%20of%20Governance%20for%20Charities%20and%20IPCs%20%282017%29.webversion.pdf. Copyright by The Charity Council 2017. Reproduced with permission.

According to The Code, charities with gross annual receipts or total expenditure of less than $50,000 (whichever is higher) are excluded from submitting the GEC. However, these charities are still strongly encouraged to refer to The Code and apply its principles.

Based on the COC Annual Report in 2016, out of the 2,217 registered charities in 2015, 56.2% were small charities (with annual receipts below S$500,000) while the remaining 43.8% were large charities (with annual receipts of more than S$500,000). For ease of discussion, this booklet will use the same definition.

2.3 Charity Governance

What is required for Charities Financial Management?

The Board of a charity is responsible for putting in place the principles and practices of good governance in the organisation. As members of the public donate and volunteer services to charities, it is important that charities stay effective, transparent and accountable to their stakeholders. The Code guides charities to have in place good governance practices, so that the public can make an informed decision on which charity to support.

The Code operates on the principle of 'comply or explain'. It is organised into nine broad principles. A summary of The Code is outlined below.

Figure 1: Principles of Charity Governance in Singapore

Board Governance
The Board is responsible for the charity's compliance with its governing instrument, all relevant laws and regulations. Section covers the importance of Board independence, and Board and Board Committees' roles and responsibilities.

Conflict of Interest
There should be clear policies and procedures set in place to declare, prevent and address potential conflicts of interest.

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.

Programme Management
Outlines the operations and programmes directed towards achieving the objectives, clearly defined outcomes, and measurement of effectiveness and outcomes.

Human Resource and Volunteer Management
Covers appropriate human resource and volunteer management policies.

Financial Management and Internal Controls
Relates to the basic operational controls, internal control systems for financial matters, budget planning and monitoring, capital asset management, and reserves management.

Fundraising Practices
Covers the best practices on the transparency and accountability of a charity's fundraising activities, such as the use of third-party fundraisers and accountability to donors.

Disclosure and Transparency
Charities should be transparent and accountable in operations. This includes making annual report publicly available, and disclosure of remuneration and benefits.

Public Image
Requires an accurate portrayal of image to be consistent with charitable objectives.

Note:

Adapted from "An Overview of Charity Governance in Singapore," by Sim, Loh, Tay and Hoe, 2017. Retrieved from https://www.fas.nus.edu.sg/swk/doc/CSDA/CSDA%20Y3%20Charity%20Governance%20-%20Booklet%201.pdf. Copyright by the Department of Social Work, Faculty of Arts and Social Sciences, National University of Singapore 2017. Reproduced with permission.

The Code and the GEC cover specific recommendations for both reserves and investment policies. These recommendations are applicable to all charities and IPCs.

Figure 2: Reserves Management Clauses

RESERVES MANAGEMENT

- The charity should maintain some level of reserves to ensure its long-term financial sustainability.
- The charity should develop a reserves policy and **disclose its reserves policy** in its annual report [NOTE: This is a legislative requirement for charities with gross annual receipts or total expenditure of $500,000 and above, and all IPCs.]
- The charity should ensure that **restricted funds** and **endowment funds** are set up solely for clear and justifiable needs.

  The charity should make sure that these funds are used or transferred to other funds only after getting the permission of the donor to do so.

  The charity must inform prospective donors of the:
  - Purpose of the funds; and
  - Amount of funds needed.

  For existing restricted and endowment funds, the charity must disclose the **purpose, size** and **planned timing of use** for these funds.
- If the charity invests its reserves, it should do so in accordance with an **investment policy** approved by the Board. It should also obtain advice from **qualified professional advisors** if deemed necessary by the Board.

Note:

Adapted from "Code of Governance for Charities and IPC". Retrieved from https://www.charities.gov.sg/manage-your-charity/Day-to-Day-Operations-of-Charity-IPC/Documents/Code%20of%20Governance%20for%20Charities%20and%20IPCs%20%282017%29.webversion.pdf. Copyright by The Charity Council 2017. Reproduced with permission.

The Code requires charities to maintain reserves to ensure its long-term financial sustainability. As such, charities are required to develop a reserves policy and disclose it in their annual reports. If the charity chooses to invest a part of its reserves, it needs to obtain advice from a qualified professional, if the Board deems that it is necessary. The Board also needs to approve the investment policy. Under The Code, a charity needs to provide a rationale if it sets up restricted funds or endowment funds.

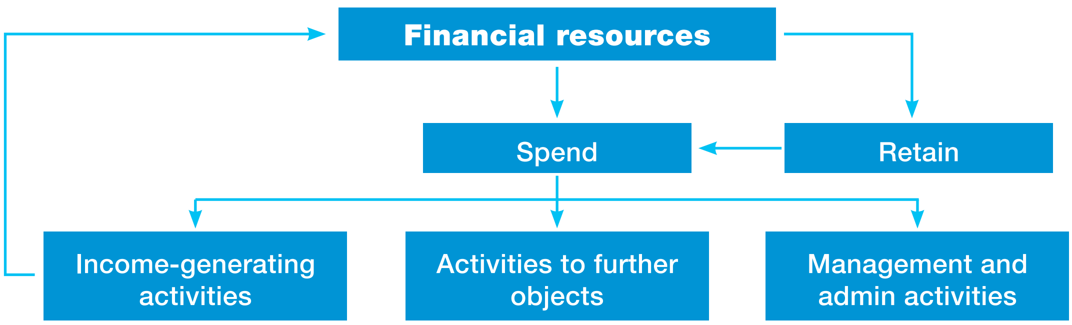
In the GEC, charities are required to disclose if they have invested their reserves and if they have a documented investment policy approved by their Board. All charities are required to provide this declaration in their annual GEC submission.

With an understanding of the key legislations and guidelines surrounding reserves management in Singapore, Chapter 3 will discuss how local charities manage their reserves. This will be followed by Chapter 4 which will outline why and how local charities invest their reserves.

CHAPTER 3
Managing a Charity's Surpluses and Reserves

To maximise its impact today and over time, a successful SSOrg manages its finance resources optimally and operates with a tight overview on the flow of funds. Charities face two competing demands on its financial resources, such as spending to meet beneficiaries' needs in the present, and setting funds aside to sustain the charities' work in the long run (Association of Chief Executives of Voluntary Organisations, 2012). These competing demands are illustrated below in *Figure 3*.

Figure 3: Competing Demands on Social Service Organisations' Financial Resources



Note:

Adapted from "Beyond Reserves: Why do Charities hold Reserves", by Association of Chief Executives of Voluntary Organisations, 2012. Retrieved from http://www.sayervincent.co.uk/wp-content/uploads/2015/07/BeyondReserves.pdf. Copyright by Association of Chief Executives of Voluntary Organisations, 2012. Reproduced with permission.

SSOrgs must manage their financial resources effectively. A charity's financial resources include contributions by donors and the organisation's earnings from investments. These financial resources can be utilised for activities that would further the organisation's objects. Otherwise, they can be retained and saved for future use.

Prudent management of financial resources is key to ensuring any charity's long-term financial sustainability. To begin, charities need to spend within their means to generate surpluses so as to build their reserves. It is both the Board's and management's duty and responsibility to ensure that the reserves are well-managed and that appropriate risk management practices are in place to protect the reserves until they can be used wisely or expended as intended by the donor (Association of Chief Executives of Voluntary Organisations, 2012).

The following sections explain the relationship between reserves and surpluses, the importance of reserves and how to develop a reserves policy. This chapter also features a case study on the social service sector's financial management practices in Singapore and two box stories which highlight how charities in Singapore manage their reserves.

3.1 What are Surpluses and Reserves?

Surpluses refer to the amount of excess cash or resources that is left after paying the debts or other obligations owed by a charity. The size of a charity's surplus is relative to its size. Typically, larger charities have a larger surpluses.

Reserves consist of both the charity's restricted and unrestricted funds. Restricted funds can only be used for specific purposes. It serves to provide assurance to donors that their contributions will be used according to their wishes. Endowment funds are a form of restricted funds. The capital in endowment funds can only be used for investment or for the benefit and purpose of the charity (Charity Council, n.d.). These funds can influence a charity's reserves policy, and thus should be discussed together for financial planning purposes.

Unrestricted funds can be used for any purpose deemed appropriate by the charity. Charities prefer unrestricted funds since they can determine how to use the donation. Unrestricted funds are used to calculate a charity's reserves level. The reserves level signals a charity's ability to service its expenses using only unrestricted funds and provides an indication of the charity's overall resilience. The reserves level of a charity in a certain financial year is calculated by taking the ratio of unrestricted funds to annual operating expenditure for that year. This provides an indication of the charity's overall resilience. Ideally, this should be three years of the charity's annual operating budget.

3.2 The Importance of Reserves

Insufficient reserves threaten a charity's continued existence (Charity Portal, n.d.-a). Reserves are the charity's main financial resource in managing its risks and obligations. They allow the charity to quickly respond in a crisis, such as when there are significant unbudgeted increases in operating expenses and/or losses in operating revenues (National Center for Charitable Statistics, 2010).

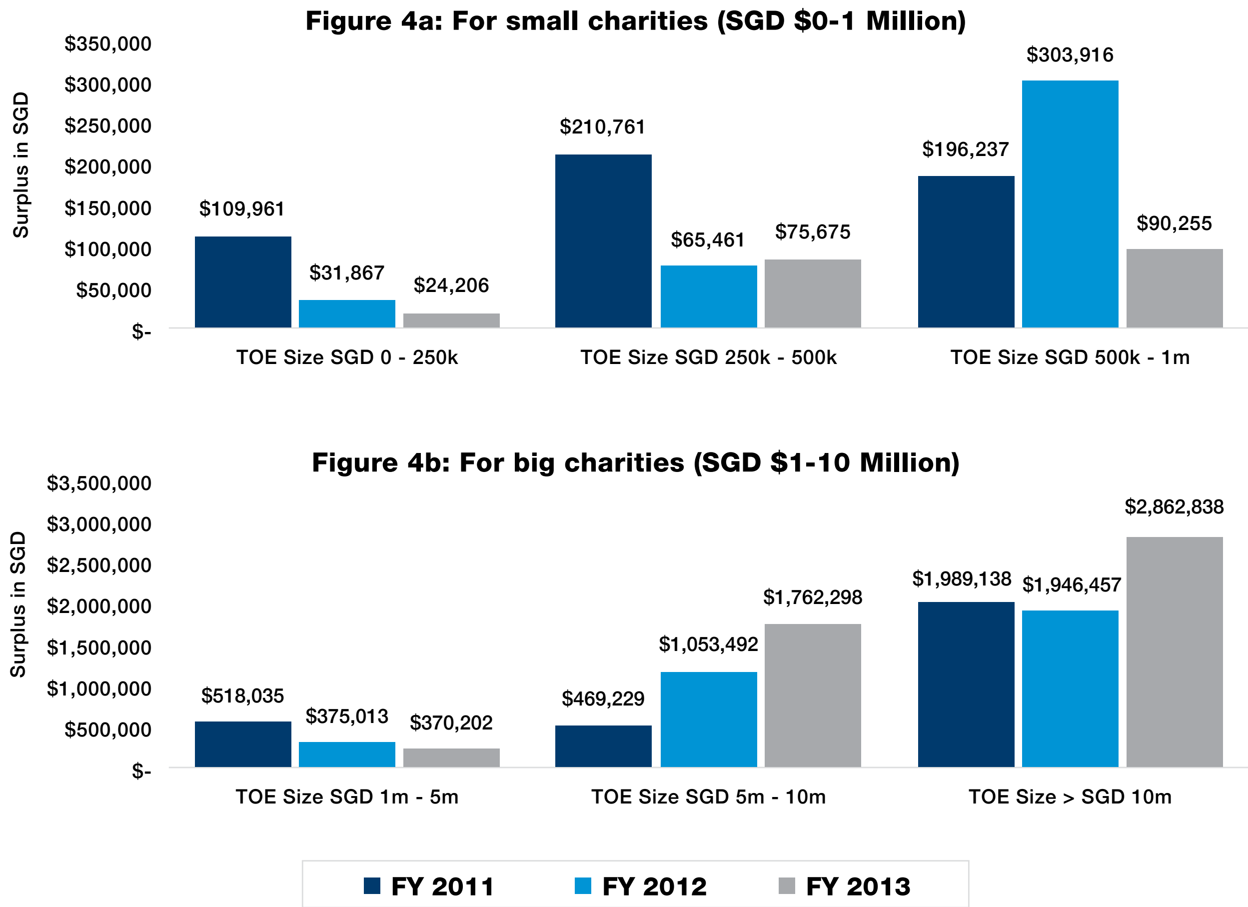
Kids Company, a charity based in the UK, closed in 2015 due to the improper and negligent financial management. The organisation had low reserves and a serious cashflow issue, but they were still expanding their programme operations in spite of their financial position. The poor management of the charity's finances resulted in a lack of funds for reserves and investment. The collapse of Kids Company was due to the charity's lack of transparency and accountability on the use of funds.

Instead of aiming for a sector standard of an 'appropriate' reserves level, the level of reserves that a charity needs is dependent on its business model (Kay, 2018). It is therefore important for a charity to have sufficient cash reserves available to prevent a possible cash flow deficit. However, some charities feel that having a large reserves would not make them attractive to donors. This is because donors would want their donations to be used directly in the charity's programmes instead of being saved for subsequent fiscal years (Marudas, 2004). Charities also believe that the government will provide additional financial help during tough times. However, holding low reserves may impact the charity's long-term financial sustainability. Without reserves, the charity risks having its funds depleted over time and may have to find alternative ways to manage its cashflow problems.

3.3 Managing of Charities' Reserves in Singapore

A study by the National University of Singpore on 202 IPCs from FY 2011 to FY 2013 revealed that larger charities experience year-on-year increases in their surpluses while smaller charities experience a decline in their level of surpluses (Sim, Ghoh, Loh & Chiu, 2015).

Figure 4: Breakdown of Surpluses by Total Operating Expenditure (TOE) during FY 2011 to 2013



Note:

Adapted from "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," by Sim, Ghoh, Loh and Chiu, 2015. Retrieved from https://www.fas.nus.edu.sg/swk/doc/CSDA%20An%20Exploratory%20Study%20on%20the%20Financial%20Characteristics%20of%20IPCs%20in%20the%20Social%20Service%20Sector.pdf. Copyright by the Department of Social Work, Faculty of Arts and Social Sciences, National University of Singapore 2017. Reproduced with permission.

The study also found that a charity's reserves comprise of different levels of restricted, unrestricted and endowment funds. As reflected in *Table 3*, larger charities were found to have their resources spread across different kinds of funds. On the other hand, smaller charities kept their reserves chiefly in unrestricted funds (Sim, Ghoh, Loh, & Chiu, 2015). Larger charities have sufficient unrestricted funds in their reserves to maintain financial stability and deliver their obligations. They are also able to lock down a greater portion of their reserves for designated purposes in their restricted and endowment funds.

Table 3: Breakdown of Reserves by Total Operating Expenditure (TOE) in FY 2013

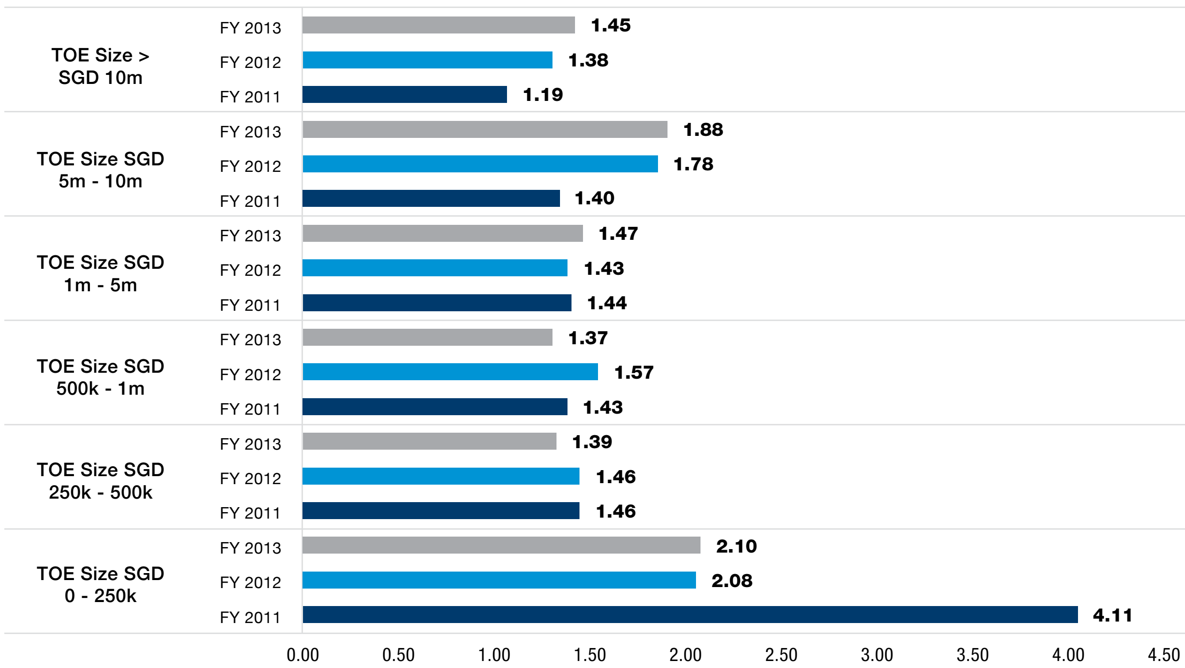
Breakdown of Different Type of Reserves (FY 2013)			
TOE Size (SGD)	Unrestricted Funds	Restricted Funds	Endowment Funds
0 – 250k	86.46%	13.54%	0%
250k – 500k	97.39%	2.61%	0%
500k – 1m	72.23%	27.77%	0%
1m – 5m	74.75%	19.38%	5.87%
5m – 10m	83.54%	11.27%	5.19%
>10m	75.47%	20.06%	4.47%

Note:

Reproduced from "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," by Sim, Ghoh, Loh and Chiu, 2015. Retrieved from https://www.fas.nus.edu.sg/swk/doc/CSDA%20An%20Exploratory%20Study%20on%20the%20Financial%20Characteristics%20of%20IPCs%20in%20the%20Social%20Service%20Sector.pdf. Copyright by the Department of Social Work, Faculty of Arts and Social Sciences, National University of Singapore 2017. Reproduced with permission.

Most charities in Singapore maintain enough unrestricted funds to cover approximately 1.19 to 1.88 times of their annual operating expenses. The study also found that smaller charities with a TOE size of SGD 0-250K maintain unrestricted funds amounting to two years of their annual operating budget. The reserve level of charities of various TOE sizes across three financial years is illustrated in *Figure 5* below.

Figure 5: Ratio of Unrestricted Funds to Annual Operating Expenditure by TOE Size (FY 2011 to 2013)



Note:

Reproduced from "The Social Service Sector Sector in Singapore: An Exploratory Study on the Financial Characteristics of Institutions of a Public Character (IPCs) in the Social Service Sector," by Sim, Ghoh, Loh and Chiu, 2015. Retrieved from https://www.fas.nus.edu.sg/swk/doc/CSDA%20An%20Exploratory%20Study%20on%20the%20Financial%20Characteristics%20of%20IPCs%20in%20the%20Social%20Service%20Sector.pdf. Copyright by the Department of Social Work, Faculty of Arts and Social Sciences, National University of Singapore 2017. Reproduced with permission.

The following case studies on the Society for Wings and the Young Women's Christian Association detail how local charities manage their reserves. The reserves management practices adopted by these two charities are different due to their size. This results in each charity having a different reserves level. Society for Wings is a small charity and maintains its reserves at a level to cover 12 months of its annual expenditure. On the other hand, YWCA is a large charity and holds reserves that are three times of its expenditure.

Box Story 1: Society for Wings

About the Charity[2]

Society for Wings (WINGS) is the only charity in Singapore that focuses on women aged 40 years and above. WINGS was established in June 2006 with the mission to empower these women to embrace ageing confidently and live well by being socially connected, staying healthy and being financially secure. WINGS organises fitness classes for these women to prevent their deterioration of physical health. The charity also forms interest groups to help the women remain integrated in the community and improve their mental health by preventing mental illnesses such as Alzheimer's disease and depression. In addition, WINGS

[2] "About Us." WINGS. Accessed March 14, 2018. https://www.wings.sg/knowing-us/.

aims to improve the financial independence of these women, by conducting skills training classes to promote lifelong learning and increasing their employability. Most importantly, WINGS provides an avenue for the women to bond and form friendships for mutual support.

Reserve and Investment Practices

1. How does your charity allocate an appropriate level of reserves?

The reserves that WINGS has set aside enables the organisation to fulfil its continuing obligations and provides the means for the development of WINGS' principal activities. The Society targets to maintain its reserves at a level which is at least equivalent to 12 months of annual operating expenditure, in view of the nine to 12 months' lead time for grants to be approved and disbursed.

a. Can you please share with us some challenges that your charity faced in the process and how you resolved them?

A good understanding of the financials (cash flow, income streams, committed expenditure) and close tracking of expenses against budget are necessary to ensure that the organisation does not draw down on its reserves. Some of our Board members who have financial background mentor our staff who have inadequate financial knowledge.

2. Why is it important for charities to invest?

It is important to generate investment income to supplement our income from activities and grants.

a. What are some important considerations for charities to note when investing?

Investment timescale, risk assessment of investment, and availability of deposit protection/insurance scheme for cash placed with banks.

3. Why is it important for charities to allocate reserves?

It is to ensure that WINGS is able to fulfil its continuing obligations.

4. Could you share with us the roles your charity's CFO, CEO, the Board, the investment committee play in the charity's reserves and investments?

Although WINGS does not have a CFO, CEO or investment committee, our Board decides on the reserves policy and investment policy. Our Audit and Compliance Committee also conducts necessary reviews as well as checks to ensure compliance with the approved reserves policy and investment policy.

We are also fortunate that more than half of our Board members have worked or are still working in senior positions in the financial industry.

Note: This box story is prepared by CSDA, based on an interview conducted with Ms Janice Goh (President of Society for Wings) and Ms Lim Lian Choo (Treasurer of Society of Wings).

Box Story 2: Young Women's Christian Association (YWCA)

About the Charity

The Young Women's Christian Association (YWCA) was founded in 1875 by a band of like-minded women committed to serving the community with compassion. YWCA is one of Singapore's most established women's charity organisations. With the aim to support underprivileged women, children, youth, elderly and disabled Singaporeans, YWCA kick-started a slew of initiatives that include child development centres, workshops for mothers transitioning to the workforce, excursions for elderly members, and a hostel for girls aged between 18-25 years old who lack an ideal home environment to return to after leaving children's or girls' homes.

Reserve and Investment Practices

1. **How does your charity allocate an appropriate level of reserves?**

   YWCA targets to maintain an optimal level of operating reserves equivalent to three years of its budgeted expenditure, from surpluses generated by its social enterprises. These reserves are the source of funding that ensures that the Association's beneficiaries and the needy continue to receive assistance in the event of donations drying up or during an economic downturn.

   The Association regularly reviews and manages its reserves policies to ensure optimal capital structure, taking into consideration future capital requirements and capital efficiency, prevailing and projected profitability, projected operating cash flows and projected capital expenditures. In addition, the Association also maintains a capital replacement fund for large scale asset renewal and has designated funds for training and major projects. These allow the Association to focus its fundraising efforts on charitable projects.

   The Capital Replacement Fund was first set up by the Board of Management as a sinking fund for the major refurbishment of Fort Canning Lodge (FCL), a hostel situated in the YWCA building that includes accommodation and Food & Beverage (F&B) services. Funds are transferred from the General Fund, which consist of accumulated operating surpluses over the years, to the Capital Replacement Fund. The Association is not subject to externally-imposed capital requirements.

2. **Could you share with us some challenges that your charity has faced and how they were resolved?**

   FCL funds all the Association's community services. FCL needs to carry out regular building maintenance to keep its premises in good condition. In addition, the YWCA building was built over 20 years ago and underwent major upgrading works in 2011. In order to compete with newer hotels, any upgrading or refurbishment of the building would entail a large capital outlay.

Childcare services form another part of our operational core, and has been experiencing challenges in children enrolment, shortage of experienced programme staff and fierce competition from other preschool operators.

3. What does your charity invest in?

We place our excess funds in Fixed Deposit with major banks.

While we explored bond investment in the past, we decided that fixed deposits made the most sense, considering our limited funding and prudent investment policy.

4. Why is it important for charities to invest? What are some important considerations to take note of when investing?

Investments are needed for capital preservation and growth of excess funds. When investing, we take into consideration the following:

i. The investment knowledge of the Senior Finance Manager, Executive Director, and Board Members
ii. Accessibility of investment instruments offered by banks
iii. Availability of funds for operations for the next two to three years
iv. Investment related in-house specialist skills
v. Risk and Return. As we are dealing with public funds, charities are generally risk-averse. All funds are meant to be channelled to help the vulnerable.

5. Why is it important for charities to set aside money for reserves?

Reserves ensure the continuity of our operations, programmes and services so that we can continue to do good.

6. Could you share with us about the roles that your charity's CFO, CEO, Board and Investment Committee play in reserves and investment management?

Our Senior Finance manager is accountable for our finances. The Investment Committee is in charge of new placements in fixed deposits. All major capital expenditure that requires a chunk of our reserves can only be committed upon approval from Board members.

Note: This box story is prepared by CSDA, based on an interview conducted with Mrs Leung Yee Ping (Executive Director of YWCA) and Mrs Pua Bee Lay (Senior Finance Manager of YWCA).

3.4 Reserves Policy

A charity's reserves level can impact the organisation's sustainability. Reserves levels are expressed as the ratio of reserves to annual operating expenditure. *Table 4* details how the reserves level can negatively affect the charity.

Table 4: Reasons and Implications for Reserves Levels

Years of Reserves	≤ 1 year	> 10 years
Possible Reasons for Level of Reserves	• A newly set-up charity. • A self-help charity with no staff and therefore wants to use up all its income each year. • Charity's income is volatile in nature and has high expenditure commitment. • Charity is working on some financial difficulties that it is facing.	• Prudent hedge against fluctuations in income. • Well-endowed charity with a steady and reliable income from investments and donors who believe in its cause. • A charity which responds to costly and unpredictable emergency situations. • Retention out of habit or unwarranted caution.
Implications	• May threaten the charity's continued existence, presenting a risk of insolvency. • May deter potential donors from donating if its viability is under threat. • May hamper proper planning of the charity. • May create insecurity amongst beneficiaries, supporters and employees. • May cause charity to spend much time and effort dealing with the problems of insufficient working capital rather than getting on with the main purposes of the charity.	• Conflict with the charity's implied duty to apply income within a reasonable time to further its objects • Charity fails in its duty to treat current and future beneficiaries fairly. • Public may be put off by perceived 'nest egg'. • Hoarding at the expense of obvious immediate needs.

Note:

Reproduced from "Reserves Policy Guide for Charities", by Charity Portal, n.d.-a. Retrieved from www.charities.gov.sg/Documents/Reserves_Policy_Guide.doc. Copyright by Charity Portal, n.d.-a. Reproduced with permission.

A reserves policy states the level of reserves held and the reasons why the funds are kept. A comprehensive reserves policy needs to clearly outline the goals for funds held in the reserves, identify people and processes authorising the use of reserves and set requirements surrounding the reporting and monitoring of reserves. A charity's reserves policy is important as it helps the charity be accountable towards their stakeholders. The development of a reserves policy should be integrated within the charity's financial planning process. A good reserves policy is key to help the charity better manage its finances and reflects the charity's ability to balance the needs of current and future beneficiaries (Charity Portal, n.d.-a).

The charity could also include a reserves policy in its annual reports and undertake a regular review of the policy and reserves level as this could help identify potential financial and operating risks. Variations in the charity's reserves methodology can lead to variability in calculating its reserves level. Thus, for a more consistent approach, there is a need for reserve requirements to be clearly established.

Elements of a Reserve Policy

According to Singapore's 'Reserves Policy Guide for Charities' (Charity Portal, n.d.-a), a charity should strive to detail the following in its reserves policy:

i. The amount of reserves (unrestricted funds) as of date of reporting and the funds distributed across restricted funds and endowment funds;

ii. A reserves level (expressed in the ratio of reserves to annual operating expenditure) that the Board agrees the charity needs and the reasons why the charity needs this level of reserves;

iii. The steps that the charity is going to take to establish or maintain reserves at the agreed level; and

iv. The arrangements for monitoring and reviewing the policy on a regular basis.

A sample template of a reserves policy provided is shown in the next page.

Appropriate Reserves Level

The Reserves Policy Guide for Charities'[3] recommends that charities consider the following factors when deciding on an appropriate reserves level:

i. Discussion with the manager, treasurer or members of the finance committee;

ii. Analysis of cash flow;

iii. Analysis of existing funds and reserves;

iv. Review of future income streams with an assessment of their reliability;

v. Review of committed expenditure and how far this is controllable;

vi. Examination of past trends;

vii. Examination of the likely changes in the main source of income;

viii. Assessment of how the charity may cope with changes in the main source of income;

ix. Studying the likely effects on the beneficiaries;

x. Assessment of the risks faced by the charity, and how likely these are to materialise;

xi. Forecast of the level of income in future years (taking into account the reliability of each source of income, and the prospects for opening up new sources);

xii. Forecast of the expenditure in future years based on planned activities;

xiii. Analysis of any future needs, opportunities, contingencies or risks, assessment of the likelihood that each of those needs may arise, and potential consequences should the charity be unable to meet them.

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[3] The Reserves Policy Guide for Charities is obtained from the Charity Portal website. It can be accessed from this link: https://www.charities.gov.sg/Documents/Reserves_Policy_Guide.doc.

Template for Reserves Policy to be Disclosed in Annual Report

	Current Year	Previous Year	% Increase / (Decrease)
Unrestricted Funds (Reserves)			
Restricted / Designated Funds:			
- Building Fund			
- Education Fund			
- Others			
Endowment Funds			
Total Funds[4]			
Ratio of Reserves[5] to Annual Operating Expenditure[6]			

The reserves that we have set aside provide financial stability and the means for the development of our principal activity. We intend to maintain our reserves at a level which is at least equivalent to *(a set range, amount or manner of calculation, with justification/ reasons).* We intend to use the reserves in the following manner in *(state time frame)*:

a.
b.
c.

The Board regularly *(state regularity like quarterly, etc)* reviews the amount of reserves that are required to ensure that they are adequate to fulfil our continuing obligations.

---

[4] Total funds include unrestricted, restricted, designated and endowment funds.

[5] Unrestricted Funds.

[6] Charitable Activities and Other Operating and Administration Expenses.

CHAPTER 4

How Charities in Singapore Invest their Reserves

Most charities adopt a conservative approach towards investment and place their funds in safe, low-risk options. Apart from being prudent in financial management, charities should actively use their reserves as part of a finance strategy to develop greater sustainability, by diversifying their income streams. Investments could generate an additional source of income and help charities build up and better manage their reserves (Sim, Loh & Teo, 2017).

This section details how charities in Singapore invest their reserves. It begins by covering the local guidelines with regard to investing reserves. Next, it discusses the differences between investment practices of small and large charities, and how large charities can go about engaging an investment professional. The chapter concludes with a box story on the investment practices of SATA CommHealth.

4.1 Local Requirements

According to the 'Guidance for Charities Engaging in Business Activities' report by the Commissioner of Charities (2016), for the purpose of accountability, investments made by charities should be undertaken in consultation with stakeholders. The use of a charity's reserves should be kept within certain boundaries and be guided ultimately by its charitable purpose. The Board is responsible for the proper use of the charity's investment decisions.

Charities need to be transparent about their investment activities. In addition, investments undertaken cannot distract the charity from its core charitable purpose. Investment should not expose the charity's asset to significant risks and the Board should consider all potential risks and returns prior to making an investment.

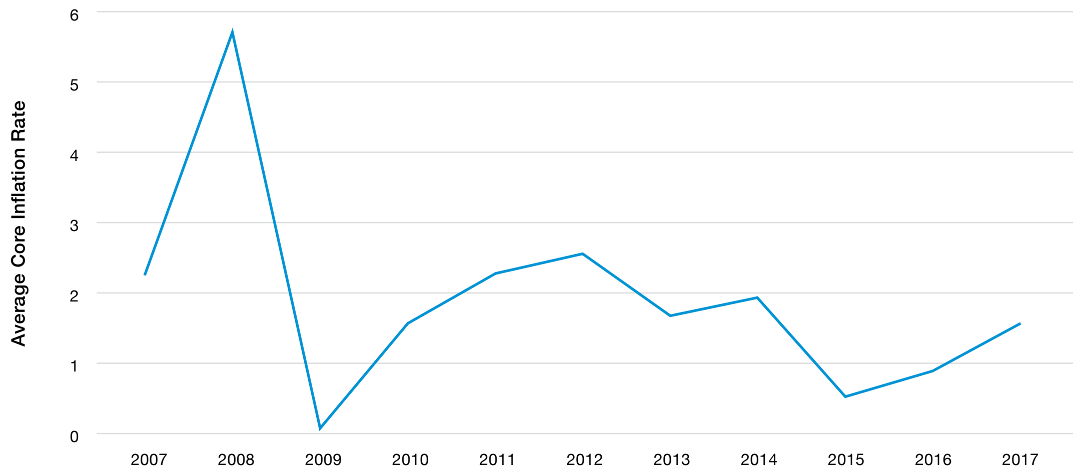
According to The Code, a charity that chooses to invest in its reserves needs to do so in accordance with an investment policy approved by the Board and should consider seeking professional investment advice.

4.2 Investment Management for Small Charities

The investment principles that charities follow would be dependent on the kind of funds their reserves comprise of. Unrestricted funds are usually used to meet operating expenses. Hence, when they are invested, they are kept in a liquid form. Conversely, reserves in the form of restricted funds or endowment funds can be locked away into less liquid assets, which promise higher yields over a longer period of time.

A small charity may need the monies in the near term and have a shorter investment horizon (< 3 to 5 years). Such charities will typically stick to the more liquid asset classes like equities, fixed income, or cash.

Figure 6: Monetary Authority of Singapore (MAS) Core Inflation Rate, Year-on-Year



Year	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Average Inflation Rate (%)	2.2	5.7	0	1.5	2.2	2.5	1.7	1.9	0.5	0.9	1.5

Note:

Adapted from "MAS Core Inflation", by Monetary Authority Singapore, 2018. Retrieved from http://www.mas.gov.sg/Statistics/Other-Statistics.aspx

Small charities tend to be more conservative with their investments, with a very small allocation in high risk assets. The size of a charity makes it vulnerable to major drawdowns. Hence, smaller charities prefer holding on to cash, even if it becomes increasingly untenable as an investment strategy due to the small returns.

With reference to *Figure 6*, inflation rates have been increasing steadily since 2015. When charities invest, they should seek returns that exceed the rate of inflation to escape the inflation trap. Charities should focus on long-term trends, instead of short-term variability. Historical evidence demonstrates that stock markets tend to generate returns over time that outstrip the inflation which would otherwise erode the value of the initial sum. Investing over the long term can therefore deliver sustained benefits for charities and their beneficiaries (Jenkins & Rogers, 2015).

If trustees make the right investment strategy and determine the right distribution rate, they can increase the probability that their investment will retain real value in the long-term. This allows trustees to be able to spend on the investment returns long after the original donation is exhausted. Trustees of charities that aim to expend their funds within a specific time frame may also find it useful to invest some or all their assets, to protect against the effects of inflation and take advantage of any potential to increase value. Although the long-term brings opportunities, the journey will have its short-term twists and turns as the value of investments go up and down. This volatility over the short term is the risk investors take in return for the potential reward of better returns over the long term. A charity should look to beat inflation and maintain their spending power, rather than avoid short-term volatility.

Charities and IPCs can also invest in conventional Singapore Government Securities. There are no limits on the amount of government securities that can be held by institutional investors, and these securities are guaranteed by the government. This low risk option provides small charities a safe way to grow their money. Small charities can also consider other fixed-income products such as bonds issued by Statutory Boards. By having some funds locked away in considerably safe investments, the charity can grow their reserves rather than place the reserves in low yielding bank deposits.

4.3 Investment Management for Large Charities

Unlike small charities, large charities have larger reserves, and thus have the advantage of diversifying their investment portfolios. They can spread their investments over different asset classes, providing stable returns. Larger charities that have to manage considerably large reserves should engage the services of investment professionals.

Engaging Investment Professionals

Successfully managing an investment portfolio takes time, skill and expertise. Hence for trustees, engaging the services of an external investment fund manager is more practical and efficient than trying to manage the investments themselves (Charity Commission for England and Wales, 2011). Charities with large reserves should engage an external investment professional to provide them with advice on an investment policy that meets their requirements.

External professionals can also be employed to help develop, implement and review the charity's investment strategy (CFA Institute, 2010). These experts can partner trustees in carrying out their responsibilities. In particular, trustees can delegate areas that require specialised expertise, such as investment analysis and selection. However, trustees remain responsible for monitoring the external professionals and ensuring that the charity's objectives are duly met.

Trustees need to make sure they have sufficient funds before engaging an external professional. A charity that decides to hire an external fund manager needs to factor the cost of hiring the fund manager in addition to the amount of funds to invest. The charity also needs to decide on the employment terms and acting capacity of the fund manager. A fund manager employed as an advisor must obtain approval for transactions, but can be given discretionary powers to act independently and make decisions on the trustees' behalf.

Selection criteria and process

When selecting an appropriate fund manager, trustees need to understand each asset management firm's background and qualifications. The charity should also enquire about how the firm plans to execute the charity's investment policy and achieve its financial objectives (Charity Commission for England and Wales, 2011).

Trustees should hire a competent fund manager with a good track record that is able to meet the charity's needs. A fund manager with experience in investing for the non-profit sector will be aware of the rules and regulations that charities need to comply with. The fund manager should tailor an investment approach specific to the charity that is aligned with the organisation's financial objectives.

Trustees should request for the fund management firm to provide a breakdown of charges and fees that the charity is expected to pay, so that the charity is aware of the full cost of engaging an investment professional. Additionally, both the charity and the firm need to establish a reporting schedule so that the charity is kept up-to-date on the progress of their investment performance.

Over time, trustees should work to develop a sturdy framework for appointing, discharging and maintaining managers that is designed to promote a long-term investment focus in line with the charity's overall financial strategy (CFA Institute, 2010). Benchmarks and performance targets laid down in the charity's IPS should allow trustees to objectively evaluate the manager's performance.

The following box story covers the investment practices of SATA CommHealth (SATA), a large local charity.

Box Story 3: SATA CommHealth (SATA)

About the Charity

SATA CommHealth (SATA) is a charitable care services provider, serving the public and beneficiaries with a comprehensive range of radiology, homecare, health screening and general practitioner services. SATA aims to be a trusted integrated care provider for the vulnerable and elderly in the community. It does these through its seven medical centres, homecare visits, mobile X-ray units, Mammo-On-Wheels bus (mobile mammography service) and Doctor-On-Wheels service. Additionally, SATA runs a Community Health Centre in Jurong, which provides ancillary services for eye and foot screening. These services complement the services provided by local General Practitioners.

Reserves and Investment Practices

1. **Why do you invest your funds instead of putting them in a fixed deposit?**

   We want to make sure that our resources are productively used, taking into account the level of investment risks we are willing to bear. Over a 12-year period from 2006 to 2017, the total returns from our investments amounted to about $34 million. Had the funds been placed in a fixed deposit, the returns would have been about $4 million. Investing the funds generated much higher returns than placing them in fixed deposits.

2. **Can you please share with us what is in SATA's Investment Policy Statement (IPS)? Do you invest in equities/bonds? What are the restrictions and risks that you take by investing?**

   Firstly, our IPS defines our key investment objectives as capital preservation, with long-term stable growth achieved through good returns and bearing a prudent level of risk. In addition, our key investment strategy is to have reasonable exposure to a wide range of investment opportunities in various asset classes to achieve adequate diversification for the desired results. These include equities (including REIT and ETFs) and fixed income securities. Specific limits around asset classes are also clearly defined, which balances our returns and risks. For example:

i. Equity: Securities must be listed and traded on the Singapore Stock Exchange and/or a recognised and established foreign stock exchange. Investment in securities of any single issuer shall not exceed 10% of the equity allocation of the portfolio.

ii. Fixed Income Securities: Typically bonds with specific credit ratings acceptance guidelines. No single issuer shall not exceed 10% of the fixed income portfolio market value.

iii. Structured Products: Investment in all Structured Products will be subject to our Investment and Finance Committee (IFC) approval and if approved, shall not exceed 10% of the total investment funds.

iv. Cash and Deposits and Money Market Instruments: The Fund may invest in money market instruments if the issue is denominated in S$ and rated a minimum of BBB/Baa2.

3. What is SATA's selection process when it engages an external investment professional to manage its funds and investments?

Request for proposal (RFP) would be addressed to various fund managers through advertisement or by invitations. Proposers would be evaluated based on factors such as their investment strategy, financial strength, skills and experience of their investment team, and fees structure. The potential fund managers would be shortlisted for further review and selection by the IFC. The Board will ultimately approve the appointment of the fund manager.

4. Can you please share with us SATA's performance of reserves and investment?

SATA's portfolio returns for 2017 was approximately 10% (or over $5 million), nett off management fees and trading fees. The portfolio returns for 12 years from 2006 to 2017 averaged 5% per annum with total returns of about $34 million.

5. What benchmark does SATA use to measure the investment's performance?

Performance benchmark depends on the level of risk SATA is willing to accept for its investments. Under current allocation model, the performance benchmark is about 5%.

6. Can you please share with us your experience during a Financial Crisis? What did you do?

SATA stayed invested through the financial crises and achieved our long-term target of returns on the investment portfolio. This was even though we were negatively impacted during two severe financial crises.

We saw the most severe decline in terms of investments during the financial crisis (subprime crisis) of 2007 to 2009, specifically in 2008. Our return of investment was -9.6% in 2008. The portfolio allocation in equities was lowered in 2008 and that mitigated the impact on the return of the investment.

The fear of contagion from the European Sovereign Debt Crisis contributed to the occurrence of the financial crisis of 2011. The return of the investment portfolio was -7.2% that year.

7. At what stage should charities start with IPS and investments?

Charities with large reserves or endowment funds may invest their funds in financial instruments such as equities and bonds, to preserve the value of their funds or to generate income so as to further support their charitable objectives.

The charities must ensure transparency in their investments and must not be distracted from their charitable goals. They will have to take into full account the potential risks and returns and must not expose their charitable assets to significant risks.

8. What should charities do during an emergency?

Our IFC receives regular updates from the fund manager on the value at risk of the investments as well as simulated ("what if's") scenarios. In volatile market conditions, the fund manager would have already taken a more conservative position in comparison to the usual asset allocation. In an emergency market whereby potential losses are significant, the IFC would convene an emergency meeting to:

i. evaluate the impact of the portfolio under different market scenarios;

ii. relook at the asset allocation strategy and risk tolerance; and

iii. decide on any further rebalancing of the investment allocation and portfolio.

Note: This box story is prepared by CSDA, based on an interview conducted with Professor Themin Suwardy (Director, SATA; Chair of Investment and Finance Subcommittee) and Mr Ang Hao Yao (Former Chairman, SATA; Member of Investment and Finance, Audit, Governance and Nominating, Human Resource, and Tender Subcommittee).

CHAPTER 5

Developing a Written Operating Reserves Policy for a Charity

Chapters 3 and 4 detail the reserves and investment practices of charities in Singapore. Due to a lack of local materials, this chapter provides practices and guidelines from other countries on how charities maintain accountability when managing their reserves.

First, there needs to be an understanding of why charities hold reserves. Secondly, charities need to be aware of the considerations they have to make in determining an optimal level of reserves. Thirdly, charities have to establish procedures and rules governing the use of this predetermined level of reserves.

5.1 Reasons for Holding Reserves

Research undertaken in 2003 by the Charity Commission for England and Wales reveal some of the reasons why charities hold reserves (Association of Chief Executives of Voluntary Organisations, 2012). These are ranked in order of decreasing importance:

i. Ensuring continuity in the event of a large variation of income
ii. Spending in emergencies
iii. Paying for specific future projects
iv. Bridging cash flow problems
v. Covering specific liabilities
vi. Generating income

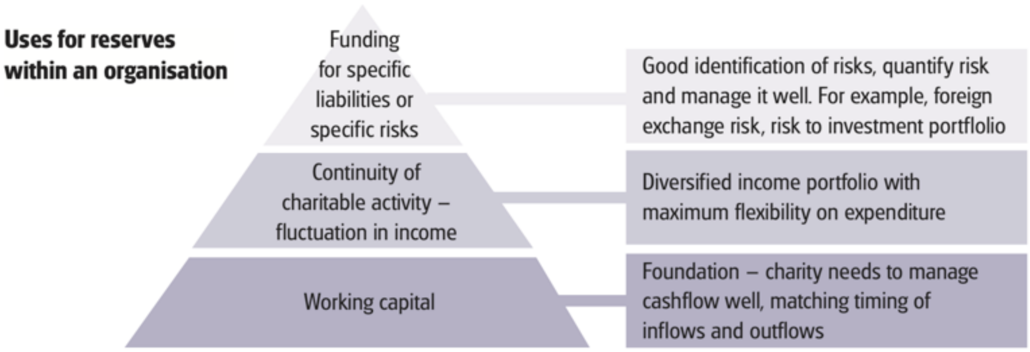
Charities should retain reserves to manage continuity. Maintaining continuity includes retaining reserves to meet forecasted expenditure commitments as well as unforeseen changes in the external environment (Association of Chief Executives of Voluntary Organisations, 2012).

Charities can set aside spare reserves for investments. These investments could generate extra income, which can be contributed back to the reserve pool of the charity. This will be discussed in greater detail in Chapter 6. However, charities are discouraged from accumulating too much reserves, as donors may not wish to have their donations saved for subsequent fiscal years. Instead, they may want the charities to spend it in more immediate times (Sim, Loh & Teo, 2017).

5.2 Determining Reserves Level

Firstly, when planning how much reserves to maintain, the charity should establish the level of working capital it needs. This is done through good cash flow forecasting where the charity has to match income streams to outflows. One method for determining reserves, as provided by ACEVO, is illustrated in *Figure 7*.

Figure 7: Uses of Reserves within an Organisation



Note:

Reproduced from "Beyond Reserves: Why do Charities hold Reserves", by Association of Chief Executives of Voluntary Organisations, 2012. Retrieved from http://www.sayervincent.co.uk/wp-content/uploads/2015/07/BeyondReserves.pdf. Copyright by Association of Chief Executives of Voluntary Organisations, 2012. Reproduced with permission.

Secondly, the charity has to factor potential fluctuations in income into its reserves levels. For example, if the charity maintains a well-diversified income portfolio, they may have a better ability to contain fluctuations. Otherwise, the charity can look to fundraising to build up additional resources in its reserves. Forecasting is recommended regularly because one cannot predict income for a year ahead.

Lastly, once the charity has established cash flow and income forecasts, they should identify and quantify specific liabilities and risks they may face. These may change throughout the course of a year, and the charity's board needs to make periodic reviews.

5.3 Managing Reserves

Charities must be accountable to the public. According to The Code, checks and balances should be in place, alongside authorisation processes governing the usage of reserves. The National Center for Charitable Statistics (NCCS) and the Charity Commission for England and Wales (CCEW) provide useful guidelines in the area of reserves accountability, specifically accountability procedures, frequency of reviews, and the Board's responses to reserves surpluses and shortfalls. These are covered below.

Accountability Procedures

The accountability procedures that they recommend include:

i. Approval processes concerning the usage of reserves;
ii. Personnel charged with the responsibility of exercising oversight over operating reserves ratio and balance, as well as implementing policies where relevant; and
iii. Requirements "for recalculating the formula of the operating reserve balance and distributing the excess operating reserve balance or funding operating reserve deficiencies" (National Center for Charitable Statistics, 2010, p.20).

A charity's management should be responsible for monitoring the reserves balance. This allows the charity to note substantial variances between expected and actual reserves level (if any) and possible explanations to account for these differences. If significant variances are observed, management should incorporate this observation as part of its routine financial reporting to the Board or relevant committee, so that relevant actions may be enacted as soon as possible to rectify the disparity (National Center for Charitable Statistics, 2010; Charity Commission for England and Wales, 2016).

Frequency of Review

Charities are highly recommended to review their level of reserves throughout the year and not merely once a year. This allows charities to better monitor fluctuations in reserves within the year, to better assess their financial health. Reviews may also be held more frequently should a charity expect to encounter circumstances which significantly impact its operations or finances (National Center for Charitable Statistics, 2010; Charity Commission for England for Wales, 2016). When re-evaluating its reserves policy, a charity should also consider the specific responses the Board may adopt with regard to reserves surpluses and shortfalls.

Board's Response to Reserves Surplus

Charities should note the timing and possible explanations when their actual reserves exceed the target levels. This allows charities to adopt the appropriate actions as necessary (Charity Commission for England for Wales, 2016).

This action should be framed within an explicit internal policy regulating the charity's use of reserves surplus. Charities may consider tapping into the accumulated reserves surplus to meet unexpected cash flow requirements in times of need (National Center for Charitable Statistics, 2010; Pg.22).

An example of a policy statement regarding reserves surplus is presented below.

> "If the operating reserves exceed the targeted reserve level for three consecutive years, the excess [or x% of the excess] should be made available for current use."

Board's Response to Reserves Shortfall

Charities should consider whether a shortfall in reserves is a result of circumstantial causes or more deeply-rooted issues. In the latter case, a broader re-evaluation of finances and reserves might be needed to assess the charity's existing financial management (Charity Commission for England and Wales, 2016). Subsequently, the charity should take the appropriate actions as necessary.

This corrective action should be framed within an explicit internal policy regulating the Board's response to shortfalls in reserves levels. This policy varies according to the charity's needs and should be formulated in discussion between the charity's executive and Board. Charities may consider cutting their expenses and/or undertaking more fundraising to create a projected surplus. This surplus may then be used to replenish consecutive shortfalls in their reserves (National Center for Charitable Statistics, 2010, Pg.22).

An example of a policy statement regarding reserve shortfall is presented below.

> "If the operating reserve is and has been less than 75% of the targeted reserve level for two consecutive years, the Board of Directors, in the absence of any extraordinary circumstances, should adopt an operational budget that includes a projected surplus sufficient to rebuild operating reserves over the following two years, back to its targeted reserve level."

CHAPTER 6

Managing Charity's Investments

A charity has to draft an Investment Policy Statement (IPS) that dictates and limits the types of investments the charity or its fund managers can undertake. This chapter covers portfolio and risk and performance management using materials from other countries. For charities to be good financial stewards, some understanding of investment management is required. Charities can hire investment professionals to manage their investments, and governing Board members must be more cognisant of the ways in which their reserves are being invested. As emphasised in the 'Guidance for Charities Engaging in Business Activities' published by the office of the Commissioner of Charities (2016), the charity's investments must not be distracted from its core charitable purpose or expose its assets to significant risks.

6.1 Investment Policy Statement (IPS)

An IPS is a written record documenting the "various investment parameters within which the Investment Committee will need to manage the investment portfolio" (CFA Society Singapore, 2013). The IPS provides the objectives, benchmarks, metrics and constraints upon which the charity frames their investment strategy. Overall, an effective investment strategy ensures the longevity of the charity by providing financial backing for its own mission (CFA Institute, 2010).

To be more specific, the investment policy adopted by a charity should account for a number of factors. These factors may include the charity's mission, the acceptable level of investment risk, rationale for seeking investment returns, policy asset mix, management structure of investments as well as assessment of investment performance.

Those charged with governance over the charity's investments should bear overall responsibility of establishing, maintaining, and reviewing the IPS. An IPS should be prepared by the charity even if the charity employs an external investment manager. The investment manager can provide advice to the charity when drafting the IPS, to ensure its feasibility. The IPS subsequently sets the framework against which the investment manager should base investment decisions on (CFG & Charity Investors' Group, n.d.).

The following subsection outlines the elements of an IPS. Information is taken from the 'Elements of an Investment Policy Statement for Institutional Investors' by CFA Institute (2010).

Key Elements of IPS

While the content of each IPS is specifically tailored to the charity's financial needs, there are at least four common broad areas: (i) Scope and Purpose, (ii) Governance, (iii) Investment Objectives, Risks, and Returns and (iv) Risk Management. These areas should be covered explicitly and thoroughly in any IPS that aims to be truly applicable, accessible, and actionable.

(i) Scope and Purpose

The IPS should lay out the charity's general financial background and define the investor, investable assets, the financial objectives of their investments as well as the value objective of their investments.

In the introduction, the IPS should state the charity's investable assets and any restrictions, where applicable. These include assets that are not currently part of its investment portfolio. The IPS should also cover how investment works in conjunction with the charity's other financial activities to further its overarching financial objective (CFG & Charity Investors' Group, n.d.). For instance, investments may be made by charities with the purpose of diversifying its source of income and reducing its dependency on donations.

Finally, the IPS should detail an investment strategy that is aligned with the organisation's missions and values. The status of the charity as an advocate of social well-being suggests that an investment strategy could also include "explicit requirements and/or prohibitions regarding the nature of allowable investments that support or detract from the mission". For example, the tobacco and gaming industries are activities that a charity could explicitly state not to invest in.

(ii) Governance

An IPS outlines the governing persons, structure, and processes of the charity. Governance begins with those at the very top. The table below summarises general principles governing the conduct of Board members.

Table 5: Code of Conduct for Board Members

INVESTMENT MANAGEMENT

Code of Conduct for Endowments, Foundations, and Charitable Organisations

A. Act with loyalty and proper purpose

Members of the Governing Body must:

1. Establish sound investment management practices that seek to maximise impact of the organisation's activities.
2. Understand the organisation's mission and appropriately consider its impact within the investment strategy.

3. Place the interest of the organisation, its donors, and its beneficiaries above their own.
4. Avoid conflicts of interest pertaining to the implementation of the organisation's investment strategy whenever possible. Disclose annually and manage actual and perceived conflicts of interest that realistically cannot be avoided.
5. Not personally solicit, offer, or accept any gift, benefit, or consideration that could reasonably be expected to affect their loyalty to the organisation.
6. Not place unreasonable constraints on future Governing Body members in the management of the endowed resources.

B. Act with skill, competence, prudence, and reasonable care

Members of the Governing Body must:

1. Dedicate sufficient time to prudently implement the organisation's investment objectives and policies.
2. Maintain an appropriate level of knowledge of investment markets, products, and strategies in order to fulfil their duties.
3. Have a reasonable and adequate basis for investment decisions supported by active and thorough due diligence of the investment strategies of the organisation.
4. Appropriately manage the financial risks of the organisation and the endowed resources.
5. Utilise external professionals when appropriate in the development, implementation, and review of the organisation's investment strategy.

C. Abide by all laws, rules, regulations, and founding documents

Members of the Governing Body must:

1. Understand and ensure compliance with the laws, regulations, and governing documents pertaining to the organisation's investment practices.
2. With regard to the organisation's financial resources, report any suspected illegal, unethical, or financial irregularities to the appropriate parties.

D. Show respect for all stakeholders

Members of the Governing Body must:

1. Take actions to maximise benefits from the endowed resources for the intended lifespan of the organisation.
2. Ensure a proper balance of all applicable stakeholders' interests in the operations of the organisation while respecting the intention of the organisation's donors.
3. Seek to minimise the volatility of beneficiary and operational budgetary support through prudent financial management.
4. Maintain confidentiality and establish policies and procedures that address retention and/or redistribution of information.
5. Communicate with stakeholders in a timely, accurate, and transparent manner.

E. Review investment strategy and practices regularly

Members of the Governing Body must:

1. Assess the performance and integrity of investment managers in stewardship of the endowed resources by an agreed upon set of standards, benchmarks, and metrics.
2. Review the actions of the investment committee regarding performance in implementing and adherence to the principles of the organisation's investment strategy and policies.
3. Review and adjust investment practices and strategies to best meet the organisation's objectives and to maximize benefits available from the endowed resources.

Note:

Reproduced from "Elements of an investment policy statement for institutional investors", by CFA Institute Guide, 2010. Retrieved from https://www.cfainstitute.org/en/advocacy/policy-positions/elements-of-an-investment-policy-statement-for-institutional-investors. Copyright by CFA Institute 2010. Reproduced with permission.

(iii) Investment Risks and Returns

When drafting an investment strategy, the charity could also explicitly address the organisation's risk tolerance and constraints to their investments.

Risk Tolerance

All investments involve a certain degree of risk. Charities must carefully consider what level of risk they are able or willing to accept in order to achieve the charity's investment objectives while safeguarding its best interests and upholding its wider mission. Subsequently, the level of acceptable level of risk charities are able and willing to undertake to obtain their investment objectives should be clearly stated in the IPS.

Constraints

The IPS must address the constraints relevant to the charity's investment activities. These constraints may be external or internal and are often closely related to the types of risks the organisation faces (CFA Institute, 2010).

Firstly, the IPS should establish liquidity requirements. The higher the identified need for access to cash in the short or medium term, the higher the percentage of investments that should be made in instruments that can be liquidated on short notice. Secondly, the IPS should define a minimum time horizon by which the charity's performance targets should be met. This establishes a deadline where charities may assess the performance of their investment against the expected returns and take corrective actions as necessary. Lastly, the IPS should assess whether planned investments could have an impact on future investment opportunities. For example, "some hedge funds or private placements may require defined lockup periods that prohibit access to the investment capital". While these investments may fall within the objectives and tolerable risks set out by the organisation, they nevertheless could affect the ability of future members to manage financial resources.

(iv) Risk Management

The IPS addresses processes relevant to a charity's risk management. To this end, the IPS should specify a reporting mechanism for performance measurement in which the frequency of review is established (CFG & Charity Investors' Group, n.d.). The IPS should also identify risk measurement metrics in which parameters are defined. An assessment of the risk profile of its investment portfolio should also be specified in the IPS. Finally, the IPS should prescribe a portfolio balancing process that spells out the range of variation from the target allocation that is acceptable for each asset class in the investment portfolio.

6.2 Portfolio Management

The challenge in investments is in ascertaining which asset classes would be suitable for the charity to hold, based on both long-term and short-term needs and perspectives.

This section provides an overview of the products charities can choose to invest in.

Asset Classes

Some broad asset classes include cash deposits, bonds, equities, property or land, and alternative investments like private equities and hedge funds. Please refer to **Appendix A** for a description of these asset classes.

Portfolio Diversification

Charities face volatility risk with regard to their investable assets. This volatility varies across different asset classes. For instance, bonds are usually less volatile than equities since their returns are typically fixed and known. However, equities have historically produced higher returns. Charities need to account for these differences when allocating assets for their investment portfolios (Charity Commission for England and Wales, 2011).

Charities can mitigate capital risk by spreading investments across different assets. This is known as portfolio diversification. Portfolio diversification improves the financial stability of the charity. A well-diversified portfolio allows charities to balance out losses from one asset class with better returns from another asset class. Moreover, a charity with an investment portfolio where risk and return levels are carefully balanced against one another would be shielded from sharp or unexpected market fluctuations (Charity Commission for England and Wales, 2011).

Strategic Asset Allocation (SAA) vs. Tactical Asset Allocation (TAA)

When maintaining and diversifying their investment portfolio, charities can take one of these approaches: Strategic Asset Allocation (SAA) or Tactical Asset Allocation (TAA). The differences between the two approaches are summarised in the following table.

Table 6: Comparison of Strategic Asset Allocation vs Tactical Asset Allocation

Strategic Asset Allocation (SAA)	Tactical Asset Allocation (TAA)
Passive Approach	Dynamic Approach
Used for Long-Term	Used for Short-Term
References the IPS to determine asset classes used in allocating percentages	Investments can be made in non-IPS defined asset classes. Infringement of originally set thresholds of different asset classes is possible.
Does not create active risk. Does not generate active returns.	Creates active risk. Portfolio managers are, hence, expected to generate active returns.

Note:

Reproduced from "Strategic Asset Allocation (SAA) vs. Tactical Asset Allocation (TAA)", by CFA FRM Guide, 2016. Retrieved from http://cfafrmguide.com/strategic-asset-allocation-saa-vs-tactical-asset-allocation-taa/. Copyright by CFA Institute 2016. Reproduced with permission.

These two approaches should not be mutually exclusive as both SAA and TAA can be used together. In fact, TAA is often used to complement SAA. As explained in the table, tactical strategies involve making adjustments to long-term target weights of different asset classes. These adjustments are for a limited time only and are put in place to capitalise on market or economic opportunities that might arise over the short or medium term. The original strategic asset mix is restored once the desired gains are achieved.

While the purpose of this chapter is to help charities rein in risk, tactical strategies can nevertheless give managers greater flexibility in seeking alternative returns that can protect the portfolio against the adverse impact of unfavourable events.

Portfolio Rebalancing

Over time, asset allocations are likely to shift away from its original portfolio mix as some investments yield better returns than others (Jaconetti, Kinniry & Zilbering, 2010). Regularly monitoring the portfolio to see if it needs to be adjusted in order to restore the balance is known as portfolio rebalancing.

The main goal is to rein in exposure to risk by ensuring that the portfolio does not become overly reliant on any single investment or asset class. Unless the charity's risk appetite or financial goals have also altered, asset allocations should remain consistent with IPS guidelines.

Although the focus here is on lowering risk rather than boosting gains, a sound rebalancing strategy could help improve returns by making the most of diversification. For instance, easing back on an investment that has done well would allow charities to lock-in gains while positioning the portfolio to take advantage of other market opportunities.

Deciding when or how frequently to rebalance can be a complex matter. Clear guidelines should be laid down in the charity's IPS; for example, setting out the criteria used to trigger rebalancing. If time is the only criterion, rebalancing can be carried out based solely on a pre-set schedule (e.g. half-yearly, annually). If threshold is chosen as the only criterion, rebalancing is triggered when holdings drift outside the predetermined range set for target allocation. If time and threshold are co-existing criteria, the portfolio should be reviewed on a pre-set schedule, and rebalancing only occurs if the threshold is exceeded at the time of the review (Jaconetti, Kinniry & Zilbering, 2010).

6.3 Risk Management

There is no risk-free investment as stocks, bonds, mutual funds and exchange-traded funds can lose value (Kiernan, 2018). Once charities understand the factors that affect various investment products and the risks each instrument poses, charities will be able to formulate appropriate countermeasures.

Investment Risks

Firstly, instead of just looking at asset classes and their features, charities can take a macro view with their risk management by considering broad categories of risks that they may face when investing their reserves. Types of investment risks include: Capital Risks, Market Risks, Tax Risks, Liquidity Risks, Environmental, Social & Governmental Risks, Valuation Risks and Counterparty Risks.

Please refer to **Appendix B** for the description of each investment risk.

Risk Management Statement

In the UK, charities that are under a legal requirement to be audited have to disclose in their trustee's annual report a risk management statement. The risk management statement covers the charity's understanding of possible risks with their investments and how they would address them (CCEW, 2010). A risk management statement brings about greater transparency for all interested parties and lays down clear guidelines for investment managers to follow. Charities in Singapore can consider drafting a risk management statement.

Issues to Cover

In both form and content, the statement will probably reflect the size and complexity of the charity's overall structure and its activities. Some key aspects and requirements of a risk management statement as recommended by the Charity Commission for England and Wales (2010) include an overview of the risk identification process, an indication of whether identified risks have been reviewed or assessed and a confirmation that control systems have been set up to mitigate the risks.

A more detailed reporting approach could cover other areas as well. The statement could include a lengthier discussion of the main risks faced. The risk management statement could describe how the identification of major risks link to the charity's operational and strategic objectives. It could go beyond basic risk assessment and evaluation to offer a more in-depth discussion of how likely certain events are to occur, and their potential impact. Additionally, it could also include the trustees' review of key outcomes achieved through the risk identification processes, and insights into how these processes are monitored and assessed.

6.4 Performance Evaluation

Reviews should be conducted regularly as part of the charities' monitoring and assessment procedures. This allows charities to determine how well their investments are performing and if their portfolio is being managed in line with the overall agenda.

An important aspect of this review is the consideration of any specific requirements or restrictions on investment opportunities stemming from the organisation's mission. As investment practices evolve, it may become necessary to enhance or remove specific characteristics of the investment strategy, to protect the organisation's reputational integrity.

The reviews should assess the charity's investment performance as well as the service provided by the investment manager, if any. There are three components to performance evaluation: Performance measurement, performance attribution, and performance appraisal (Bailey & Richards, 2017).

'Charities and Investment Matters: A guide for Trustees (CC14)' by the Charity Commission for England and Wales (2011) and 'A Primer for Investment Trustees: Understanding Investment Committee Responsibilities' by Bailey and Richards (2017) are the main references for the material below.

Performance Measurement

Performance measurement involves calculating a charity's returns against the benchmarks set in the IPS. Through the specified benchmarks, the charity can monitor and measure the performance of its financial portfolio over a specified period of time.

As the precise nature of the benchmarks and targets may vary for each charity, charities may wish to consult the expertise of other independent organisations. Charities may also compare the performance of their funds against those that belong to other charities with similar investment objectives.

Performance Attribution

Performance attribution involves identifying the variables that are responsible for the relative performance of the charity's returns, as stated in the performance measurement.

When funds are found to have underperformed, charities should be understanding if an acceptable reason is provided. Conversely, where funds are performing significantly above average, charities should ensure that these high returns do not come at the cost of exposure to risks exceeding its risk tolerance.

Performance Appraisal

Performance appraisal involves evaluating the sustainability of a charity's investment performance, as identified in the performance measurement. This offers charities insight into the quality of their existing investment programmes and reveals gaps where corrective actions may be undertaken, if necessary.

Modifications to the investment policy may be appropriate in the rare occasion where the appraisal concludes that current investment practices do not concur with "changes in the investment landscape, such as new practices or products", which may fundamentally alter expected risk-reward relationships among asset classes. Decisions concerning alterations to the investment policy should not be hurried but be undertaken only after careful deliberation. If the modifications are seemingly time-sensitive, the problem is more likely to be a management issue than a policy one.

Frequency of Reviews

Charities may choose to hold regular reviews. They are also encouraged to hold one in case of emergencies, such as changes in economic outlook during a global financial crisis or when there are material changes in the charity's financial circumstances.

Assessing Investment Managers' Services

When reviewing the service provided by an investment manager, charities should ask these questions:

i. Are the terms for the services of the investment manager suitable for the charity?
ii. How is the performance of the investment manager?
iii. Is the investment manager still suitable to carry out the function of investing for the organisation?
iv. Are the terms of the appointment still appropriate?
v. Is the manager complying with the policy statement?

Where there is a need to intervene, charities should consider the capacity in which they are to intervene. For instance, a charity can provide clear directions, revise, or terminate its agreement with the investment manager.

CHAPTER 7
Conclusion

Known as a “rainy day fund”, reserves provide charities with the flexibility to respond to unanticipated increases in operating expenses and/or losses in operating revenues. Without reserves, charities can be thrown into cash flow distress and they may not have the resources to continue delivering their programmes.

Establishing and documenting a formal reserves policy is a best practice that should be adopted by all charities. The proactive and transparent sharing of a charity’s finances and financial planning practices gives the stakeholders and donors a greater sense of comfort regarding the charity’s financial management.

The charity has to ensure that its reserves management practices are in line with local guidelines. Where investments of these reserves are made, the charity has to ensure that the investments are aligned with its overall charitable objective.

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APPENDICES

Appendix A

Asset Classes

This appendix details broadly the asset classes charities can invest in. Information is taken from "Investment Funds: Your guide to getting started" by the Charities Aid Foundation (n.d.) unless otherwise stated.

A. Cash Deposits

Cash required for the charity's day-to-day operations are normally held in an instant-access current or deposit account. The deposits generate returns via interest. These returns are the lowest amongst those generated by the different asset classes. The investment value of a charity's cash may also decline over time if the inflation rate surpasses the interest rate.

Alternatively, charities may choose to lock away cash in medium to long-term fixed deposits or notice account. These offer a higher interest rate but also restrict access to funds (Charity Commission for England and Wales, 2011). A substantial amount deposited with a single institution could secure a higher interest rate, but trustees need to also consider the risks of losing the funds. It is recommended that cash be deposited only with reputable institutions, such as those authorised by the MAS.

When deciding on the institution and the duration to place the deposit, charities should consider interest rates, timing of interest payments and access to funds and tax (CCEW, 2011). Interest rates vary from institution to institution and also by account type, so deposits should be reviewed by charities regularly to ensure that the rates given are competitive. The charity should also account for the payment frequency as timing of interest payments could affect the charity's cash flows. Contracts may place restrictions on access to funds, and this makes it difficult for charities to mobilise the funds should an emergency arise. By breaking the contract, the charity risks facing a penalty for withdrawals at a short notice or early termination. In addition, whether interest is paid gross or net of tax could have a significant impact on returns from the deposits.

B. Bonds

With bonds, one can earn returns through interest income and capital gains. Regular interest payments are made to investors throughout the bond period. Capital gains are the profits an investor makes from the sale of the bonds. While bond investments are less risky than equities, they also offer lower return rates.

Relative to cash investments, bonds are riskier in that they entail default or credit risk. Corporate bonds are generally riskier in this regard than government bonds as corporations are more likely to encounter financial difficulties that may result in their defaulting on the bond repayment.

Charities should also consult the credit ratings of the bond issuer when conducting bond investments, to minimise credit risk. Thus, charities may wish to purchase investment grade bonds where issuers demonstrate a high capacity of repaying the loan.

C. Equities

When investing in equities or stocks and shares, charities are purchasing a stake in the company. Depending on the performance of the volatile stock market and the company, the charity's returns will fall and rise accordingly. As a result, charities that invest in equities stand to gain higher returns but at the cost of simultaneously exposing themselves to higher risks. This is especially the case for investments in companies based in emerging market countries like Brazil.

D. Property

Charities can conduct property investment in different ways. For instance, charities may opt for direct investment in a property. Alternatively, charities may choose to invest in property companies as opposed to directly owning and managing the property in question. However, it should be noted that where charities engage in direct property investments, liquidity might be an issue.

E. Alternative Investments

Alternative investments refer to non-conventional asset classes like private equities, hedge funds, and venture capital. These asset classes tend to offer potentially lucrative investment returns, but are also more complex, incur higher costs and bear higher illiquidity risk.

Appendix B

Investment Risks

This appendix covers the different types of risks that charities have to shoulder when investing their reserves. Information is taken from “Charities and Investment matters: A Guide for Trustees (CC14)” by the Charity Commission for England and Wales (2011), unless otherwise stated.

The different types of Investment Risks that will be covered include:

i. Capital Risks;
ii. Market Risks;
iii. Tax Risks;
iv. Liquidity Risks;
v. Environmental, Social and Governance Risks; and
vi. Counterparty Risks.

Capital Risks

Investments made in capital markets such as the bond and stock markets come with capital risks. These risks emerge due to the markets’ sensitivity to the broad economic climate (Bailey & Richards, 2017). When economic conditions are promising, charities stand to benefit from higher returns compared to lower-risk investments. However, when economic conditions are poor, the value of the charity’s investments fall and charities face a higher risk of losing capital and/or income.

Market Risks

The four major types of market risks are explained below.

i. Inflation Risk
Investments are not immune to inflation. If the investment does not keep pace with inflation, it undermines the performance of the investment as there is a fall in value in real terms.

ii. Interest Rate Risk
Investments that pay a fixed rate of interest regularly may become unattractive if held for a long period, especially if interest rates elsewhere rise above that fixed rate.

iii. Currency Risk
There are risks associated with fluctuations in exchange rates when investing in foreign securities. Assets based in other countries will generally be valued in different currencies. If the foreign currency falls in value to the dollar, the investment may be worth less even if its home currency value has increased.

iv. Regulatory and Governance Risks
Some investments may be unregulated or based in countries where regulations are less stringent. There is a risk of these investments failing as a result of poor management and lack of regulatory controls.

Tax Risks

Tax risks arise where tax liabilities may be incurred on a charity's investments. Not all investments qualify for tax exemptions even if tax regulations do not explicitly restrict what a charity may invest in. Consequently, charities may not be granted exemption from tax on income or gains equivalent to the invested sum. Foreign investments made by charities may also be subject to foreign taxes, consequently reducing the returns made.

The IPS should account for those general and specific tax matters that may have implications for the charity's investment decision-making (CFA Institute, 2010). Before adding an investment to the portfolio, charities should ascertain if and to what extent income or gains from that investment are likely to incur taxes. Not all investments incurring tax liabilities should be excluded. A careful consideration of the potential impact and appropriate advice should be sought before arriving at a decision.

Liquidity Risks

Liquidity risks arise when a charity holds insufficient cash to meet its immediate cash demands. This occurs when illiquid investments are made, constraining the charity's ability to convert its securities into cash on short notice without incurring a loss in capital and/or income as a result.

Certain asset classes are less liquid by nature. For example, land cannot be sold off as easily as listed shares. The saleability of other asset classes also varies across time, especially in markets which are less predictable.

Charities should review their short and long-term cash needs before deciding its asset allocation as part of managing liquidity risk. Factoring their cash needs into account, charities should then invest in those assets that best accommodate their cash obligations. For instance, assets that could be hard to sell, particularly in an illiquid market, might not be appropriate for short-term investments as they could affect the charity's ability to access cash in times of need.

Environmental, Social, and Governance (ESG) Risks

Increasingly, ESG criteria are playing a key role in determining whether investment in a particular company or organisation is desirable in terms of its ethical impact and sustainable practices. Financial returns are not the only goal – such investments also aim to create social or environmental outcomes that are positive and measurable. Often, impact investing entails looking at areas such as the company's carbon footprint, Board diversity, and community development initiatives.

The competency of a company in managing such issues could affect both its image and performance in the long term. This might also have a substantial impact on the value of its shares. Moreover, investing in companies with a poor ESG track record might not reflect well on the charity.

Some examples of ESG issues relevant to charities may be found in *Table 7*. It should be noted that the list is not comprehensive. Additionally, ESG issues cannot be neatly categorised into purely environmental, social, or governmental. This is because in reality, these issues are often interlinked.

Environment	Social & Governance
• Environmental management, policy, reporting and performance • Chemicals of concern • Climate change and greenhouse gases • Mining and quarrying • Nuclear power • Sustainable timber • Pollution • Water pollution • Biodiversity	• Human Rights • Labour Standards and Supply Chains • Tobacco • Alcohol • Gambling • Military • Pornography • Animal Testing

Table 7: Examples of Environment and Social & Governance Issues

To manage these risks, the charity first needs to decide the significance of the ESG criteria in its investment policy, and the impact of the ESG policy on its image and reputation. The investment managers engaged by the charity needs to be aware of the ESG policy and abide by the guidelines. This can be achieved by the following two methods:

i. Taking into account the possible effect on returns that a company's sound or poor management of ESG risks could have.

ii. Checking whether a company discloses its ESG risk management processes and determining how the disclosure is verified.

Valuation Risks

Valuation risks arise when an asset has been overvalued due to incomplete or inaccurate data at the time of valuation. As a result, the value of the asset at the time of sale may fall short of the original estimated valuation. Unfortunately, charities facing an urgent need for capital may have little choice but to accept lower prices in order to attract a buyer on short notice.

In order to mitigate valuation risk, the charity needs to account for the valuation risk alongside the charity's risk tolerance, liquidity needs, and composition of its investment portfolio. Charities need to be aware that valuation risks are inherent in certain types of investment, and they should consult an investment manager in such situations.

Counterparty Risks

Counterparty risk arises when the organisation with which the charity conducts investment business defaults on its contractual obligations. Examples of these parties include banks, stockbrokers, investment managers or other financial service providers. Every financial transaction carries a degree of counterparty or default risk. Metrics used to gauge this risk may be found for investable assets like bonds via ratings by agencies such as Moody's and Standard & Poor's.

When dealing with counterparty risks, charities need to first determine if the business is regulated. If compensation schemes are available, these would cover partial or total losses incurred by the charity. Asides from ensuring that investments are held within a reputable company, the charity needs to establish clear performance measures and monitor the performance. Charities need to periodically review the risks and risk management strategies to ensure that they continue to meet the needs of the organisation.

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