

FINANCIAL STATEMENT ANALYSIS FOR NONPROFIT ORGANIZATIONS. AN ITALIAN PERSPECTIVE FOR VOLUNTARY ORGANIZATIONS AND OTHER THIRD SECTOR ENTITIES IN ITALY FOR A BETTER ACCOUNTABILITY

Claudio Travaglini

*Department of Management
University of Bologna in Rimini
Piazza Teatini 10 - 47900 - Rimini – Italia
claudio.travaglini@unibo.it*

Recognition of Italian third sector - Accounting and financial statement settlement – A first analysis model for financial statement in nonprofit organizations and its use for a better accountability

Recognition of Italian third sector and other entities

During the last 15 years, Italian third sector has demonstrated its vitality and has gained acknowledgment from authorities and public opinion visibility.

This is due to a complex set of body of rules and social developments that have enhanced the importance of nonprofit organizations and their contribution to the construction of social capital and to the organization of quality services.

The 1991 national law on voluntary organizations and social cooperative, the 1997 fiscal reform of non-commercial organizations and the social promotional organization law of the year 2000 have determined, together with regional sectorial and specific bodies of legislation a complex system of nonprofit organizations, which represent a significant part of the social system.

A lot more has to be done to obtain a thorough study of the features of these particular organizations, especially concerning the

development of accountability.

After it has outlined the characteristics of the most important businesses in Italian third sector, communication concentrates its attention on some hypotheses on how to read their financial statement and on projects that aim at the transformation of the information system, in order to obtain a better organization of accountability.

The first regulated nonprofit organizations, which are often confused with the entire system, are represented by voluntary organizations in which the joint and several inclination of third sector is totally achieved, and in which people spontaneously come together, without expecting any money, and work in favour of public utility.

The voluntary organization is a nonprofit organization that is run democratically. It represents the prototype of a typical and pure nonprofit organization: all relationships, from the one between the volunteers and the organization itself, to the one between the organization and the beneficiaries, are totally ruled free of any charge, and this is achieved by forbidding all kind of economic relationships between the voluntary organization and the volunteers, except for expense refunds.

In this type of organization, all institutional activities are directly developed with the participation of volunteers and paid collaborators, that carry out the following functions:

- a) service production and supply for the beneficiaries
- b) service supply in agreement with public administrations
- c) organization of volunteers and organizational support
- d) financial resources collection by the organization of events
- e) management of commercial and marginal producing activities
- f) financial management of all resources
- g) organization of general support activities.

They develop their activities in collaboration with other nonprofit organizations, especially by actions of social control and by the integration of services run by public administrations, social cooperatives and other subjects.

Social cooperatives represent third sector managerial dimension,

by running a lot of services thanks to its entrepreneurial organization, even if they have to maintain their attention on public interest and satisfy their members.

The activities of social cooperatives are represented by the management of social, health and educational services (social cooperative type A) or by training and job finding for disadvantaged people (social cooperatives type B); all these activities are prevalently committed to state and local government or are inserted in projects financed by them, and expect the social company to be paid by a sum that reflects the quality and quantity of their services.

Type A cooperative societies develop activities for

- a) local governments, through conventions and contracts;
- b) their members through self producing and consuming relations;
- c) for individuals on a payment basis ;
- d) for non paying third persons, by means of pure solidarity and thanks to pro-bono donors

in addition to supplementary activities and general support activities.

Type B social cooperatives run agricultural, industrial and commercial activities all focused on training and job finding for disadvantaged people.

The law demands that social cooperatives respect all mutual qualifications that are needed for a cooperative society to obtain fiscal facilitations, but it also determines the possibility of profit distribution and the recognition of privileged conditions for members (higher wages or other benefits).

All of this can be achieved, but it requires an even more transparent accountability for these social cooperatives, because this is the only way they can be fully qualified as nonprofit organizations and they can preserve their reputation in the public opinion.

Clubs and associations are other nonprofit organizations operating in sports or cultural and recreational services, that are now becoming recognized social promotional societies, and that carry out their activities by operating for development and by helping members and others in the management of different activities (sports, cultural, recreational).

Generally these are nonprofit organizations with associative rules and democratic orientation, that are freely determined by the articles of association, and belong to sectorial or cultural national organizations.

Sports and cultural associations develop their institutional activity by promoting initiatives addressed primarily to members and to others. Sometimes they even facilitate collaboration from members by means of favourable conditions (in comparison to the ones that are determined for others) and they distribute to members discounts on services and social activities prices, all in favour of a higher participation from members and for a higher qualification of their services.

These associations obtain financial resources from membership fees, providing of characteristic services, from incomes of organized events or from financial contributions of local government bodies that organize services and the people and from commercial sponsorship.

These associations directly run activities that are focused on social purposes by using the following functions:

- a) activities management for production and supply of typical services (cultural, recreational, sports) that members and others can obtain free of charge or by paying public financial contributions
- b) events organized to make the public aware of their associative purposes and to obtain financial resources
- c) financial management of resources for the organization
- d) general support activities, including the affiliation to umbrella federations inside this association system

The three groups (voluntary organizations, social cooperatives, social promotional associations) do not include all possible third sector organizations, but they represent a good and exhaustive example of them and they correspond to regional registers that assign facilitating statuses (in Italy nonprofit regulation has to be outlined partially by the State Government and partially by the Regional Government).

Accounting and financial statement settlement

Financial statement regulation of nonprofit organizations is seriously inadequate, due to a historical lack of attention: nonprofit organizations didn't distribute profits and therefore it was not necessary to regulate them, also because the value of having transparency in financial statement and economic operations was considered of secondary importance, even for third sector participants.

All rules in the Civil Code that concern all kinds of associations and institutions and that go back to 1941, require that the annual report be approved yearly by the assembly, without giving any kind of direction on how financial statement has to be outlined and without even talking of any kind of publication.

For social cooperatives the application of the body of rules dealing with ordinary commercial companies force them to draw out a financial statement in typical form and to make it available to all in public registers.

The fiscal body of legislation determines rules for cases of commercial activity management, to identify and tax the profit produced.

National law on voluntary organizations requires that their constitution has to indicate annual reports as compulsory; they have to show goods, contributions and legacies received and the approval formalities used by the assembly, but it does not present any particular indication on how to organize the book keeping or present financial statement.

On the contrary, it lists all economic resources from which voluntary organizations can obtain resources (contributions from members, individuals, public sector bodies, and international organizations, donations, refunds from conventions and incomes from marginal commercial activities).

For social promotional associations, that are considered to be the legal form of this association system, it is necessary to insert in the constitution that economical and financial reports are compulsory. It is also specified that it has to be approved by members, even if it doesn't indicate how it must be presented or if it

has to follow specific rules for publication.

Because of this scarce regulation of financial statement, accounting bodies have developed patterns to help the drawing up of financial statements of nonprofit organizations.

We will consider structure and interpretation of the financial annual report (with reference to qualified accountants documentation).

The purpose of accountability in nonprofit organizations is to inform public on the activities developed in accordance with the institutional mission, whereas its subject-matter is the way in which the organization has obtained and invested its resources.

The financial report of nonprofit organizations describes how the residual income is determined by the composition of different activities or defined on the specific characteristics of nonprofit organization.

In accordance with our formulation, which is different and more specific in comparison to the one used in commercial societies, incomes and costs reports in nonprofit organizations inform on how resources are obtained and used in a period of time and in reference to specific areas:

- typical and institutional activities;
- promotional activities and fund raising;
- supplementary and commercial activities;
- financial and patrimonial activities;
- extraordinary activities;
- general support activities;

The financial report describes, in a structured way, gross incomes and costs deriving from different activities (circuits and flows), and the residual income determined by comparing the sums of these values.

The minimal version only presents all settlements of this circuits, without making any reference to the relevant stakeholders such as members, government bodies, and other related entities; this structure can be used in all kinds of nonprofit organizations so that we can compare values.

In order to have a more complete knowledge of the nonprofit

organization activity, we have to specify that if the nonprofit organization institutional asset includes partners, members or associates, it is important to separate all transaction with partners from the ones that involve others.

Similarly, it's important to identify, if and when they are present, government bodies and other members of the nonprofit group as relevant stakeholders and to separately point out relationships with qualified subjects in order to create more detailed reports.

The presence of a defined outline (and the gradual creation of principles that describe how to classify and report incomes and costs) allows a structural reading of a nonprofit financial statement, and to create the foundations for financial statement analysis.

The general financial report model can be specified in reference to different types of nonprofit organizations, but it has to outline its parts by referring management areas to the reality of the characteristic businesses considered.

**FINANCIAL REPORT ON INCOMES AND COSTS
DIVIDED AND OVERLAPPING SECTIONS
MINIMAL OUTLINE**

INCOMES

Incomes from fees, donations, contributions
Incomes from institutional activities with economical relations
Incomes from typical goods-services in ordinary economic trade
Incomes from fund raising campaigns and initiatives
Incomes from supplementary and commercial activities
Incomes from financial and patrimonial management
Extraordinary incomes
Other incomes

TOTAL INCOME

Negative net income result (balanced)

COSTS

Costs for typical institutional activities supplied free of charge
Costs for typical institutional activities with economic relations
Costs for typical goods-services in ordinary economic trade
Costs for institutional payments
Costs for fund raising campaigns and initiatives
Costs for supplementary activities
Costs for financial and patrimonial management
Extraordinary costs
Organizational and general costs
Other costs

TOTAL COSTS

Positive net income result (balanced)

A first analysis model for financial statement in nonprofit organizations and its use for a better accountability

Being able to have at one's disposal a defined reporting outline of nonprofit organization balance sheet, allows us to establish first models for financial statement analysis.

This way they become tools used to formally observe accounting values, resulting from different periods in nonprofit organizations, and to express concise evaluations on the ways being applied by the organization to obtain and invest resources.

The logic used to read and interpret financial statements, thanks to a system of indexes, starts from the reading of accounting values in accordance with the defined prospects: different activities and qualified subjects that can establish relationships with the organizations (partners and members, government bodies, connected subjects inside the group).

This proposal of analysis of non profit organization financial statement doesn't represent an alternative to the social reporting, but the practical assertion that economic and monetary information contributes to outline the nonprofit organization concrete activities and performances.

The first values that have to be considered are :

- the proportional incidence of incomes and costs of every activity on the total income and costs;
- the net income of single activity on total income and costs;
- the incidence of single and significant economical aggregations, on total income and total costs.

The first index we have to consider is represented by the ratio between the typical activities incomes and total income of a nonprofit organization. This gives us the influence that typical activities have on the complex of different activities that the organization can undertake.

Inside incomes deriving from typical activities, we can estimate the incidence of the relationships being carried out with government bodies, members and other subjects of the nonprofit group, that

contains the organization itself, and the one of the major contract, in order to determine how much the organization depends on its stakeholders or on a specific one of them.

In the same way, it can be estimated the incidence of all other types of incomes on total income; we consider the influence that fund raising incomes, supplementary and commercial activities incomes, financial and patrimonial incomes have on total income. Therefore we definitely describe the resources for the organization's own financial maintenance.

The same estimations on proportional incidence can be applied on costs, describing what is the influence that program related costs and fund raising costs have on total costs, and even considering the incidence of a particular type of cost as organizational an general costs.

This evaluation gives us some information on the financial perspectives of the organization.

A further evaluation of the incidence of single activities can be made by overcoming the estimation of the partial net income of the activities and considering the net result of single activities (positive or negative, gross profit or loss) on total costs and incomes of that particular activity.

This way we'll obtain an evaluation of the incidence of fund raising result on the total funds collected or the incidence of typical management outcome on the total of incomes and costs of the management itself.

Some ratios between different types of costs are partially informative, as for example the ratio between organizational and general costs and program related costs, or the ratio between personnel costs and total costs, that give us a picture of the influence of structural costs on the total amount of resources invested by the organization.

Even the incidence of members payment (if and when it's expected) and of expense refunds to volunteers gives us some information on the way the resources are invested and on particular organizational situations.

These indexes give us the opportunity to start with a structural reading of a nonprofit organization financial statement; if we insert them in a more complex outline, we obtain a first “minimum data set identifying form” of the nonprofit organization we are analysing and this way we can compare its values to the ones of other organizations of the sector or to its own values that refer to previous periods.

Moreover, it's important to underline the problem of promoting activities and financial statement transparency in Italian third sector organizations. It is also necessary to point out that financial reporting, clear and comprehensible, is directed not only to public administrations, holders of the registers and consequently of authorizing powers and facilitating concessions, given to nonprofit organizations, but also by public opinion.

By doing this, every possible donor and citizen can be informed on the activities and economical and financial performances of nonprofit organizations. This is the only way in which social control can guarantee freedom to nonprofit organizations to pursue their purposes and to increase trust and social capital.

Thus, by means of the publication of an essential but complete accountability, handled by the organization itself with a guarantee role for public administrations, the necessary information will be given to all the public, to maintain and promote transparency and accountability.

**FINANCIAL STATEMENT ON INCOMES AND COSTS
DIVIDED AND OVERLAPPING SECTIONS
DETAILED OUTLINE**

INCOMES

Incomes from fees, donations, contributions

From members

From non members

From other subjects inside the nonprofit group

Incomes from institutional activities with economical relations

From members

From non members

From government and local bodies for contract and contributions

From other subjects inside the nonprofit group

Incomes from providing characteristic services in ordinary economic sale

From members

From non members

From government and local bodies for contract and contributions

From other subjects inside the nonprofit group

Incomes from fund raising campaigns and initiatives

From members

From non members

Incomes from supplementary management

Incomes from financial and patrimonial management

Extraordinary incomes

Other incomes

TOTAL INCOME

Net income (balanced)

**FINANCIAL STATEMENT ON INCOMES AND COSTS
DIVIDED AND OVERLAPPING SECTIONS
DETAILED OUTLINE**

COSTS

Costs for institutional payments

Costs for typical institutional activities provided free of charge

For members

For non members

For other subjects inside the nonprofit group

Costs for institutional goods-services in economic trade

For members

For non members

For other subjects inside the nonprofit group

Costs for characteristic services in economic trade

For members

For non members

For other subjects inside the nonprofit group

For government bodies

Costs for fund raising campaigns and initiatives

Costs for supplementary activities management

Costs for financial and patrimonial management

Extraordinary costs

Organizational and general costs

Other costs

TOTAL COSTS

Positive net income (balanced)

FINANCIAL RATIOS FOR NONPROFIT ORGANIZATIONS

Composition of incomes for nonprofit organizations

Incomes from typical activities/ total income

Contracts with government bodies/ incomes from typical activities

Incomes from major contract / incomes from typical activities

Incomes from members / incomes from typical activities

Incomes inside the group / total income

Fund raising incomes / total income

Major donator incomes / fund raising and donations incomes

Supplementary activities incomes / total income

Financial and patrimonial incomes / total income

Extraordinary incomes / total incomes

Analysis of the composition of costs in different classes

Program related costs / total costs

Fund raising costs / total costs

Supplementary activities costs / total costs

Organizational and general costs / total costs

Ratios of costs

Payment costs / total costs

Payment costs / program related costs

Supplementary activities costs / program related costs

Personnel costs / total costs

Costs for partners payment (also indirect) / total costs

Analysis of margins in different activities

Fund raising margin (incomes-costs) / fund raising incomes

Typical activity margin (incomes-costs) / typical activity incomes

Supplementary activity margin (incomes-costs) / supplementary activity incomes

Financial activity margin (incomes-costs) / financial activity incomes

Other analysis

Management outcome / total income

Different types of incomes from government bodies / total income

Incidence of costs for expense refunds for volunteers