

THE INSUFFICIENCY OF FINANCIAL ANALYSIS FOR THE PERFORMANCE OF NON-PROFIT ORGANIZATIONS

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Abstract

The paper work is based on the hypothesis that the financial analysis is insufficient when it comes to reflecting the performance of nonprofit organizations. Our main argument is the social purpose of non-profit organization, which is the reason why the analyst has to find optimal solutions for analyzing their performance while taking into account their social impact.

Our research focused on the conceptualizations of the performance of non-profit organizations and the adequacy of the existing models for analyzing it.

The research results refer to the limits of financial analysis regarding the performance of non-profit organizations because it can only offer relevant information regarding its effectiveness.

Keywords: *non-profit organization, financial analysis, performance, specific ratios, social impact.*

1. Introduction

The responsibility towards the stakeholders determines any entity to present financial/accounting information regarding its activity. Many times, the information in raw form doesn't say much to the user, hence the necessity to analyze them, to measure their performances based on them so that the stakeholders' requests be fulfilled.

The responsibility of non-profit organizations towards the interested parties takes shape based on the next reasons:

- the institutional purpose determines value creation;
- the social constraint determines social responsibility;
- the economic and financial constraint determines economic sustainability.

In this context, financial analysis, amongst others, becomes important for the non-profit organizations also, and not just for the corporations. However, based on the hypothesis that financial analysis isn't sufficient for nonprofit organizations and we intend for this study to expose the needs financial analysis responds to, as well as the reasons why it doesn't satisfy the stakeholders' informational needs from a non-profit organizations.

In order to achieve these objectives, we will focus our attention on the specialized literature to especially highlight those characteristics of non-profit organizations that distinguish them from companies and that have an impact on the needs that a financial analysis would respond to. Thus, we will try to identify analysis methods that adapt to their specific.

Currently, the non-profit sector in our country is poorly developed, and Romanian literature in this

domain is poor, very few authors treat the aspects of financial analysis in the frame of non-profit organization. At an international level, things are different. Among the authors' concerns, the sector of financial analysis is found, some of them building a series of models of analysis appropriate for the non-profit sector.

2. Aspects that influence performance analysis

The performance is basically shown through the information from the enteritis's result account, however non-profit organizations, through their particularity, don't achieve profit. This would be one of the first aspects which argues that the elements that generate results don't provide a sufficient basis to analyze their performance. Thus, the classical financial analysis performance can't be sufficient.

“Performance measurement tools and techniques were frequently tailored to the particular contextual features and dynamics of each nonprofit organization and on the basis of their appropriateness to organizational values, goals and working practices.”¹

2.1. The performance's points of view in the non-profit sector

A number of authors believe that the non-profit sector, performance is often judged by its three points of view:

- Economics: attempting to minimize resource consumption (inputs in the system);
- Efficiency: trying to optimize the relationship between inputs and outputs (consumption of resources/results);
- Effectiveness: the outputs are compared to the

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¹ Giacomo Manetti, The Role of Blended Value Accounting in the Evaluation of Socio-Economic Impact of Social Enterprises, *Voluntas* (2014) 25:443–464, DOI 10.1007/s11266-012-9346-1.

objectives.²

According to Cadena-Roa, Luna, Puga, associational performance has been considered as the dependent variable which can be regarded in four dimensions: efficacy, efficiency, legitimacy, and relevance. For our purposes, efficacy refers to the association's capacity to achieve its stated goals. Efficiency considers the association's ability to mobilize resources in an optimum way to achieve those goals. Legitimacy is considered both as internal and external; internal legitimacy reflects the association's capacity to have full cooperation from its members to achieve the stated goal; external legitimacy alludes to the importance that non-members confer to the association's activities and which moves them to support it. Finally, relevance refers to the social, political, economical, and cultural importance of the association's anticipated goals and unanticipated consequences. The associations may or may not be aware of their own relevance since this has been considered from a macro-perspective.³

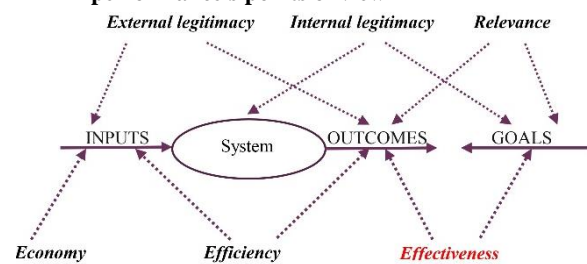
Through the figure below we present the schematization of the relationship between an organization's features of performance management. Given the Figure no. 1, for performance analysis in non-profit organizations, it's necessary to identify the inputs, outputs and objectives of the system for them to be correlated. According to some authors⁴, when identifying them, some problems are met that have to do with the measuring of:

- *the objectives* – non-profit organizations have diverse goals, some of them can only be identified, without being able to be measured in a relevant way for the performance analysis; certainly, the objectives that can be taken into consideration regarding the performance's analysis are the budgeted ones, respectively the expected revenues and expenses;

- *the outputs* – many of these can't be measured in value, for example, the progress of a child with disabilities who benefits from a foundation's program with activities in this field; however, an output indicator would be the actual amount of resources consumed in a program (expenses), but a big consummation of resources doesn't necessarily guarantee the results.

We note that the performance's analysis is not just the financial results and it's strongly imprinted by the non-profit organization's objectives which will materialize in outputs of which measurable values many times isn't representative for the performance analysis.

Figure nr. 1 -The relationships between the performance's points of view -



Source: inspired by Ionașcu, Filip, Mihai, 2003:253

2.2. The non-profit organizations' working environment.

In order to evaluate and to predict the associative performance, in specialized literature there is this tendency to neglect the environment in which the association works and to show only importance only to the intra-associative characteristics.

According to some recent theories, the associations' performances depends on the relationships the associations have with the environment they work with, not just on the internal factors and the achieved goals.

“Organizations are viewed as closed-systems and attention is set on internal management efforts to improve performance—basically considered in terms of efficiency and effectiveness. Often, when those studies refer to the environment, they consider it mainly as the context, failing to analyze the reciprocity of influence between the association and the environment.”⁵

“If we want to improve theoretically and empirically the way we measure associational performance, we should move beyond traditional theories and see organizations as open-systems whose performance is the result of organization–environment interchanges. More recent theories stress that associational performance depends not only on internal factors as those reviewed in the previous sections (“Decision-Making” and “Cohesion”), nor on the merits of their goals, but also on the relations they hold with the environment.”⁶

The organizations are means of collective action that are environment oriented. They are dependent on the environments in which they operate, being incomplete typical systems. In this way they are exposed to the external vulnerability and uncertainties. The figure below represents the main components of a non-profit organization and we can observe that all of the three dimensions influence and are influenced in

² Ion, Ionașcu, A. T. Filip, S. Mihai, Control de gestiune, Ed. Economică, București, 2003, p. 253.

³ Jorge Cadena-Roa, Matilde Luna, Cristina Puga, Associational Performance: The Influence of Cohesion, Decision-Making and the Environment, Revista Voluntar, DOI 10.1007/s11266-011-9246-9.

⁴ Ion, Ionașcu, A. T. Filip, S. Mihai, Control de gestiune, Ed. Economică, București, 2003, p. 254.

⁵ Jorge Cadena-Roa, Matilde Luna, Cristina Puga, Associational Performance: The Influence of Cohesion, Decision-Making and the Environment, Voluntar, DOI 10.1007/s11266-011-9246-9.

⁶ Giacomo Manetti, The Role of Blended Value Accounting in the Evaluation of Socio-Economic Impact of Social Enterprises, Voluntar (2014) 25:443–464, DOI 10.1007/s11266-012-9346-1, apud Aldrich and Marsden 1988, Scott 2003.

the same time by the environment in which the non-profit organization operates as presented in Figure no 2. We can see that starting with the social aspects (purchase of input elements, human resources management, projection of internally generated elements), continuing with the economic ones (output production, association's legitimacy provision and relevance for the interested parties, cost management, registered growth) up to the environment protection management, the environment is important for all the processes.

“What we mean by environmental relations includes the structural characteristics of the system where they are rooted and those of the system or systems they want to exert influence on. It also includes the reactions to associational activities from institutions, stakeholders and other publics. Thus, we call environmental relations to:

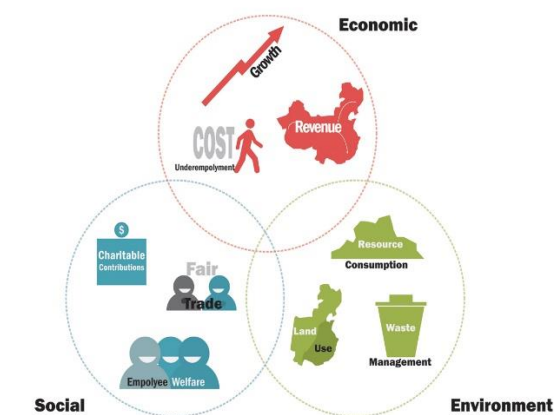
- the characteristics of the system where associations are rooted,
- the characteristics of the target system and,
- the responses from it.

In a nutshell, considering internal factors as given, what associations may achieve depends not only on their actions, but also on the way the environment enables or constrains associational strategic actions.”⁷

“There are certain accounting practices that measured not only economic performance but also social results achieved using various indicators of outcome and impact. Many of these attempts relied heavily upon voluntary information regarding quality to the detriment of quantitative and monetary assessment. In recent years, however, accountancy has made several attempts to create and implement quantitative-monetary measuring tools which can measure in monetary terms the social and economic output of, not to mention the impact generated by, all kinds of organizations (Blended Value Accounting, or BVA for short). The logic of a blended value analysis suggests that, first all organizations, create both financial and social value, and that, secondly, the two types of value creation are intrinsically connected rather than being in opposition in a zero sum equation (i.e. to generate more social value, an organization must sacrifice its financial performance).”⁸

Some authors (e.g. Manetti) have been promoted social return on investment ratio (SROI) as a way to enable the social enterprise sector to better understand the wider impacts of their services and activities and quantify the total value generated in monetary terms. The end result of the process of implementation of SROI analysis is an indicator that represents the return in socio-economic terms for every monetary unit spent on the project and/or in the organization as a whole.

Figure nr. 2 - The structure of the non-profit organizations -



Source: Triplebotlin, CC BY-SA 3.0
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3. Measuring performance through financial analysis.

Performance measurement represents one of the management's and the financial-accountant department's concerns. From the management's perspective, over time, all sort of strategies have been created, two of them being:

- the strategic model developed by Moore which is based on three pillars: social and financial value creation, sustainable support of donors and sponsors, and the organizational survival.
- the “Matacena” model which was tested by Bagnoli and Megali and is based on: social efficiency dimension, institutional dimension and economic, and financial dimension.

From the financial accounting's perspective, the performance analysis can be done considering those elements that have values that can be measured in a manner that is relevant to calculate performance indicators. In most cases, performance is analyzed on types of activities done by the non-profit organization, namely: fund-raising activity and the activities related to the undertaken programs. The indicators we present can be analyzed for a single undertaken activity, but also in relation to the activities undertaken in the past, in order to analyze the evolution in time of the performances achieved by those activities.

3.1. Performance of fund-raising activities

Within the fund-raising companies the consumed resources and the results are easy to be quantified because they have goals referring to obtaining financial or even materials resources. In order to analyze the companies' fund-raising performances, we can calculate the following indicators:

⁷ Jorge Cadena-Roa, Matilde Luna, Cristina Puga, Associational Performance: The Influence of Cohesion, Decision-Making and the Environment, *Voluntas*, DOI 10.1007/s11266-011-9246-9.

⁸ Giacomo Manetti, The Role of Blended Value Accounting in the Evaluation of Socio-Economic Impact of Social Enterprises, *Voluntas* (2014) 25:443–464, DOI 10.1007/s11266-012-9346-1, apud Aldrich and Marsden 1988, Scott 2003.

- The campaign's efficiency – by comparing the total revenues generated by that campaign to the total expenditure undertaken to implement the campaign. This indicator will show how profitable the undertaken campaign is and whether the expenses are too high compared to the generated revenues

- The campaign's effectiveness – by comparing the generated revenues to the ones hoped

- The campaign's economy – by comparing the campaign's expenses to the total expenses undertaken by the non-profit organization;

The performance can be analyzed in a more specific way applying a series of indicators to the donations, whether financial or material. Thus, for the received donations, Acumen Integrat developed the following indicators:

Table nr. 1 - Indicators concerning the donations -

The Indicator's name	Explanation
The cost per monetary unit collected	It measures the amount of costs determined by collecting monetary unit from sponsors or partners.
The average value of a donation.	It measures the average value of a received donation, by comparing the total of the donations received during a certain time period.
The efficiency of a donations' transport costs	It measures the percentage represented by the transports costs of a donation out of its total value.
The delivery time of the donation	It measures the necessary time for a donation to arrive at its destination after someone has made a commitment to offer a donation.
Received donations	It measures the percentage of donated products that were actually received, out of the number of products solicited from donors

Source: projected based on www.indicatorideperformanta.ro

Taking into consideration that the fund-raising activities operates with financial resources, we can observe that it's quite easy to build analysis models for the performances achieved. The problem comes up when we talk about according a support that is one of material resources. Most of the times, these can be measured in value, but there are cases when a

monetary value cannot be attributed to them due to some circumstances or characteristics of the donated materials. This would be a limit concerning the analysis of the performances achieved in the fund-raising zone.

3.2. Programs' performance

In order to identify the indicators that can be used in analyzing program performance, the model of how every program work has to be known, as well as all its elements: goals and objectives, resources (inputs), activities, outputs and outcomes. Outputs represent what a program actually does (e.g. informs a certain number of people regarding harmful effects of drugs consumptions), whereas outcomes are the results it produces (e.g. fewer drugs consumers). Depending on how these elements can be measured, the indicators can be projected in order to reveal the programs' performance.

In Poister's opinion, "non-profit programs should be planned and managed with an eye toward specifying and achieving desirable results. They should be viewed as interventions involving service delivery or enforcement activity that is designed to address some problem, meet some need, or impact favorably on some unsatisfactory condition in a way that has been defined as serving the public interest. The positive impacts so generated constitute the program's intended results, which would justify support for the program in the first place. A program's intended results, or its outcomes, occur "out there" in the community, within a targeted area or target population."⁹

In order to analyze the performance, a model such as the one presented in the Figure no. 3 can be used as "an organizing tool for identifying the critical variables involved in program design, the role played by each in the underlying logic, and the presumed relationships among them. Briefly, resources are used to carry on program activities and provide services that produce immediate products, or outputs. These outputs are intended to lead to outcomes, which are the substantive changes, improvements, or benefits that are supposed to result from the program. Frequently, these outcomes themselves occur in sequence, running from initial outcomes to intermediate and longer-term outcomes."¹⁰

Of all the elements involved in the programs model, the only resources that can be measured in value are the consumed resources and the number of beneficiaries. Generally, the relevant types of performance measurement include measurements of output, efficiency, productivity, service quality, effectiveness, cost-effectiveness, and customer satisfaction. Thus, in order to be able to analyze the conducted programs' performance, the involved

⁹ Theodore, H., Poister, *Measuring performance in public and nonprofit organizations*, Jossey-Bass a Wiley Imprint, San Francisco, 2003, pg. 32.

¹⁰ Theodore, H., Poister, *Measuring performance in public and nonprofit organizations*, Jossey-Bass a Wiley Imprint, San Francisco, 2003, pg.37.

resources for running the programs, the programs' beneficiaries and the staff involved are taken into consideration

If we want to analyze the performance from a financial perspective, we focus on the resource consumption, output measure, the number of beneficiaries, employees and volunteers. When calculating the costs of involved resources, the total resources consumed in the program, as well as how much fixed assets wears out for the period in which they were used to carry out the program will be taken into consideration. Resource consumption also includes the share of the expenditure on the utilities and maintenance related to the means used in the program. Likewise, the expenditure with the employees and the volunteers involved in the program under analysis has to be taken into consideration.

The relevant indicators concerning the financial performance can be calculated by reporting the following costs to the number of beneficiaries:

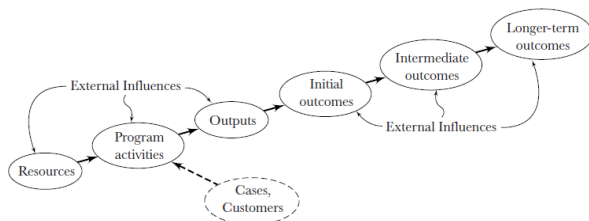
- costs of resources used in the program;
- costs of employees' wages;
- costs involving volunteers.

Output measures are important because they represent the direct products of nonprofit programs. They often measure:

- volumes of programmed activity;
- amount of work that is performed;
- the number of cases that are dealt with by a program.

In the financial performance analysis, the outputs are important as relevant information concerning the financial efficiency by comparing the costs with the achieved outputs can be obtained. Thus, efficiency indicators look at the ratio of outputs to the monetary cost of the collective resources consumed in producing them

Figure no. 3 - Generic logic program model -



Source: Poister, 2003:37

Concerning the financial performance analysis of the conducted programs in the non-profit organizations, the existing limits are connected to:

- Efficiency, in the sense that the maximum outcomes can't be quantified in value, due to the social goal of the organization, so the social impact of the changes brought in the program beneficiaries can't be quantified;
- Effectiveness, because the goals and the outcomes of a non-profit organization aren't of a financial nature, but a social one, these being able to be measured through non-financial indicators which are the tools of performance management;
- Economy, meaning that there are no parameters that provide indications of economic management of resources required for a particular program.

4. Conclusions

By exposing the characteristics of performance at the level of non-profit organizations, our study has confirmed the hypothesis that a financial analysis of the performance at the level of these types of entities would be sufficient to convey its global performance. Where the classical financial analysis can't answer the stakeholders' needs, the performance's management activities has to intervene by using specific tools in order to analyze the performance in non-profit organizations.

The performance in the non-profit organizations is seen as having social, economic and environmental facets. All of these are influenced by the environment in which the organization operates. The performance is defined in relation with the organization's goals, the consumed resources, the outputs and the achieved results from the activities, taking into account the outcomes (social impact).

At the level of non-profit organizations, we addressed the performance of fund-raising activities and of programs. In the first case, we concluded that a performance financial analysis would offer enough information concerning the conducted activities, with the very rare exceptions where material resource are donated which can't be quantified in value. In the second case, things are different. The main problem is connected to the fact that, most of the time, the outcomes of the conducted programs can't be quantified in money, which represents a limit when we talk about their efficiency and effectiveness analysis.

Beyond these limits, the performance can be analyzed with the specific tools of the performance management in the frame of non-profit organizations, a domain that can represent a new field of research that would bring benefits to the Romania's civil society.

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