Europe: Overview of Public Benefit Status

Financial Reporting in European NPOs: Is Now the Time for a Common Framework?

The International Journal of Not-for-Profit Law

VOLUME 11, ISSUE 1, NOVEMBER 2008

By Claudio Travaglini

INTRODUCTION

The role of the nonprofit sector in the European Community is widely recognized by the Commission and European Parliament,[2] which look to these organizations to promote the development and integration of EU citizens in activities relevant to the societies of member states. Recognizing the importance of these enterprises, European central bodies seek to promote growth through funding programs for training and professionalization and through communications that define the roles and the operations of these entities.

This social economy or Third Sector is very heterogeneous, not only in the types of organizations and operations, but also in the types of relationships with civil society and especially in reporting and accounting practices (Jerger and Lapsley, 1998). The European Commission and Parliament have largely avoided issuing specific rules for financial reporting applicable to all players in the social economy. (Not-for-profit enterprises engaged in business, mainly cooperatives and social cooperatives, are covered in an indirect way by the Community directive in accounting.) A large area of doubt results, particularly concerning associations and

foundations, which makes it difficult to gauge the results of these actors' contributions to the social economy. The gray area, paradoxically, covers just those types of entities that have become more pervasive within civil society and that are especially well positioned to promote integration among EU citizens.

The enlargement of the Community to twenty-five nations, connected with the free movement of people and activities, raises to extraordinary importance the need for a framework for nonprofits to report accounting information and a model annual budget that are common to all European states. Developing a common framework requires an analysis of national accounting models, including the role of cultural factors (Doupnika and Riccio 2006) . It is therefore vital to develop cultural and legislative analyses for those countries that have imposed accounting requirements on players in the Third Sector. Through these analyses, we may derive a path for the creation of a single accounting model.

This article seeks to highlight possible areas of overlap in accounting models, through an analysis of accounting regulations applicable to not-for-profit organizations in the United Kingdom, Spain, and Italy.

A COMPARISON

The accounting reports for a nonprofit aim to inform the stakeholders about the institutional mission and the means by which the organization has used resources in carrying out its activities, gauged in light of its nonprofit nature (Travaglini 2005) . Although the comparison can only start from an analysis of the rules on accounting reports, a prerequisite is understanding the procedures for training and identification.

The comparison between the methods chosen by each state to regulate the accounting reports of nonprofit entities, in my opinion, must also highlight the technical process of formal accounting and the integration of nonprofits' accounting in the model of any national or international principles and procedures for accounting and publicizing the results.

The process of harmonizing accounting requirements for the Third Sector is taking place in Europe at different speeds. All countries, however, intend to work toward national accounting standards or principles and reporting requirements for nonprofit organizations. There is some opposition toward integrating the models of accounting for nonprofit entities with international accounting standards. Some national bodies, responsible for regulating accounting and reporting of nonprofit entities, seem to be aware of the need to make the process

more transparent and provide more useful information concerning the management of the organizations. The result may be new frameworks, perhaps borrowing from those of other countries or perhaps developed from scratch.

Instead of regulation by the European Commission and Parliament, the individual states appear to be ready to develop national schemes that may in turn converge on generally compatible accounting and reporting requirements. Which approach is preferable is a debatable matter.

THE UNITED KINGDOM

The United Kingdom has a centuries-long history of regulating nonprofits, dating back to 1601 and the Statute of Charitable Uses. "However, it was only with the advent of the Charities (Statement of Accounts) Regulations 1960 (SI 1960 No. 2425) that charities were required to keep proper books of accounts, prepare financial reporting consisting of an income and expenditure account as well as a balance sheet, and keep those records for at least seven years" (Chitty & Morgan (2001), quoted in Cordery & Baskerville, 2007, p.11).

Today, the economic and financial reporting of nonprofits in the United Kingdom is governed by Accounting and Reporting by Charities: Statement of Recommended Practice (SORP). The current SORP is the result of continuous updating since 1988.[3] It took several adjustments to adapt the model of reporting to the needs of nonprofit entities and to bring it into line with the different accounting standards and financial institutions in the United Kingdom. The SORP currently in force is the result of a dialogue between the members of Charity Commission and the Accounting Standards Board. The interaction has resulted in a model of reporting consistent throughout the UK based on accounting standards for small businesses that refer to specific International Accounting Standards.

The SORP aims to provide a clear and transparent representation of the activities and financial standing of nonprofit entities with an annual income exceeding £ 100.000. The charity Commission seeks to enable citizens to compare the results and activities of organizations operating within the national territory, as well as to give operators of those organizations a guide for compliance.[4]

The model annual report that the SORP proposes provides a series of qualitative information, such as describing the evolution of the nonprofit during the accounting year of reference, as well as quantitative data. The SORP Annual Report must include the following:

1. **Reference and Administrative Details of the Charity, its Trustees and Advisors: This information specifies the nonprofit, its directors, and any independent or dependent auditor.**
2. **Structure, Governance and Management: The nonprofit must state its internal organization, its choice of legal form, and its governance structure and rules.**
3. **Objectives and Activities: The institution must highlight its objectives, role, and methods.**
4. **Achievements and Performance: The activities must also be shown through performance indicators or sectoral comparisons, to highlight the role and importance of nonprofit. This section must include fundraising activities and results.**
5. **Financial Review: This section should present the financial position of the entity and explain the reserves and the change that occurred over the previous period, giving reasons for such change.**
6. **Plans for Future Periods: Here the nonprofit should present its objectives and plans for the next accounting year.**
7. **Statement of Financial Activities: This document accounts for how the nonprofit has used its resources.**
8. **Balance sheet: This document discloses assets and liabilities, including intangible assets.**
9. **Cash Flow Statement: The document supplements the Statement of Financial Activities, representing cash flows, their origins, and their uses.**
10. **Notes on the Accounts: Here the nonprofit should explain the accounting standards used and how they were interpreted.**

The document is then drawn up under the supervision of auditors, who may be independent (an independent person who is reasonably believed by the charity trustees to have the requisite ability and practical experience to carry out a competent examination of the accounts) or internal, depending on the income levels of the nonprofit:

Gross Income of Charity	Minimum
< £10,000	Approval of accounts by
£10,000 to £250,000	Independent examina
£250,000 to £500,000	Independent examinat
> £500,000	Aud

Source: Gareth G. Morgan, 2006

Once approved, the annual report is lodged at the Charity Commission, which makes the information publicly available.

SPAIN

In Spain the rules of accounting for nonprofits were promulgated by Royal Decree 776/1998, de 30 de abril. The decree imposes a model derived from the Plan Countable General usually applied to commercial entities. The result has allowed the integration of accounting models, but without modification in light of the real needs of nonprofits. The Spanish model, however, is still relatively young, so it may be premature to judge its operation.

Spain provides two standards, depending on the value of a nonprofit's assets, the level of its revenues, and its average number of employees. Smaller nonprofits are subject to fewer accounting rules.

The "model de cuenta annuales" includes these requirements:

1. **Balance: This document lists balances, debts, and equity.**
2. **Cuenta de resultados: This document aims to explain the economic situation of the nonprofit, integrating information on receipts and expenditures.**
3. **Memory: This document, predominantly qualitative, gives information relating to the organization, its administrators and governing bodies, as well as information on changes during the accounting year.**

A comparison of the two models shows that both nations first proposed a general pattern of reporting, which was then revised and supplemented with the help of national accounting organizations. The result seeks to harmonize regulators' need for information with nonprofits' situations.

Country	Regulatory body	Acts and Standard	Basis of Accounting	
UK	UK GOV.	1993 Charities Act	Accrual (cash accounting is allowed for small entities)	Reference and A and Advisor Objectives an Financial Re Financial Activi
		1995 Charities (accounts and reports) Regulations		
		1997 Charities (annual return) Regulations		

	Charity Commission	1988 SORP Statement of Recommended Practice: Accounting by Charities		
Spain	Spanish Gov.	1964 Association Act and the Royal Decree of	Accrual	Statement of Fi
		1994 National Foundations Act		
		1998 Chart of Accounts		
	AECA	ED for the Accounting in NPO's		

Source: Torres & Pina

The UK has preferred to harmonize with the SORP accounting standards based on English accounting standards. The result looks relatively deeply into specific issues. The Spanish system, by contrast, is heavily influenced by the culture and structures of accountability of continental Europe.

Though the evolutionary path was almost the same, the documents differ in terms of content. The British annual report is more comprehensive and complex in the information requested. The English model seems to give greater attention to the role of auditors and emphasizes making the results public. In terms of the information requested, though, the two are similar.

	UK
GAAP and national accounting standards incorporated	Accounting standard incorporated: Statements Standard Accounting Practice (SSAPs); Financial Reporting Standards (FRSs); Urgent Issues Task Force abstracts (UITFs);

Incorporation of accounting International Accounting Standard	**Partial (IAS 10, 22, 29, 32 e 39)**

ITALY

The process of promoting a model of annual report for nonprofits in Italy is taking its first steps. The Italian Agency for Onlus recently approved the document "Guidelines and Schemes for the Preparation of Balance Sheets of a Nonprofit Entity." The document, of a non-binding nature, is directed at nonprofits with revenues exceeding € 100.000,00. It aims to promote uniform accounts that allow comparisons over time and among the various actors. The Italian document listing requirements, drafted with the help of academic experts and accountants, has yet to integrate national accounting standards. Accordingly, it remains embryonic.

The accounting model proposed in Italy provides for the compilation of four documents, which will be reduced to two for smaller entities (accounts of receipts and payments along with Notes). The full version requires the following:

1. **Balance sheet: The document follows the proposed model of the balance sheet for commercial entities, except that commercial entities must get an external audit.**
2. **Cash management: The document compares income and expenses for the year in dual sections, as with the Spanish model.**
3. **Notes: The document describes the entity, its governance structure, and its changes during the year, as well as the accounting principles followed.**
4. **Mission report: The document lists the aims of the nonprofit and the means through which it pursues them, along with indicating the stakeholders.**

The guidelines proposed by the Italian government are less detailed than those of the other two countries, but these are simply a point of departure. Italy generally follows the Spanish structure, though Italy requires less of smaller entities and requires non-accounting information as to the organization's mission. Though Spain and Italy require comparable information—a record of accountants' findings—the two Mediterranean countries impose no requirement of disclosure.

CONCLUSION

The UK, Spain, and Italy impose many similar requirements. The differences largely reflect local cultures and the role of nonprofits. The principle of standardization itself is the first point of overlap. So is the idea of consulting with national accounting organizations and heeding national accounting principles.

Perhaps the next step is to implement international standards. The result would allow comparison of different nations' Third Sector organizations. The standards might require an account of the overall economic situation, balance sheets, and a qualitative description of the organization and changes that occurred during the year. Development of an accounting framework that could cover all European nonprofits would begin by emphasizing the common points that now exist and try to resolve those small differences among them, such as the arrangements for publicity and review of accounting data.

Notes

1 Claudio Travaglini, claudio.travaglini@unibo.it, is a Professor in the Department of Management at Bologna University in Italy.

2 "The importance to the European economy and society of cooperatives, mutual societies, associations, foundations, and social enterprises (which together are sometimes referred to as the Social Economy) is now receiving greater recognition at Member State and European levels. Not only are they significant economic actors, they also play a key role in involving their members and European citizens more fully in Society. Social Economy enterprises are helping to meet the demands of a changing Europe. They are important sources of entrepreneurship and jobs in areas where traditional 'investor driven' enterprise structures may not always be viable." (http://ec.europa.eu/enterprise/entrepreneurship/coop/index.htm)

3 For evaluations of the impacts of regulation on British charity, see Bird & Morgan-Jones 1981, Ashford 1989, Gambling, Jones, Kunz & Pendlebury 1990, Hines & Jones 1992, Williams & Palmer 1998, and Connolly & Hyndman 2000.

4 The accounting recommendations of this SORP are based on Financial Reporting Standards currently in issue and have been developed in conjunction with the Charities SORP committee, an advisory committee made up of charity finance directors, charity auditors, academics, charity advisers and charity regulators. The committee is also structured to reflect the different charity jurisdictions of the UK. Sector involvement has been a central part of producing this SORP. The research, input and feedback provided by the sector and the SORP Committee has informed each stage of its development. The resulting document provides a platform for

transparent and consistent reporting by charities. The Commission would like to thank the SORP Committee, and all those who responded to the consultation on the exposure draft as well as all those who prepared research papers and publications that have informed this SORP's development. (Accounting and Reporting by Charities: Statement of Recommended Practice, 2005)

References

Agenzia per le ONLUS, Linee guida e schemi per la redazione dei bilanci di esercizio degli enti non profit, Milano, 22 Maggio, 2008

Charity Commission (2003), "Charity Accounts: The Framework," CC61, http://www.charity-commission.gov.uk.

Charity Commission (2004), "Charity Commission," http://www.charity-commission.gov.uk.

Charity Commission (2005a), "Accounting and Reporting by Charities: An Exposure Draft of the Statement of Recommended Practice," http://www.charitycommission-uk.gov.uk.

Charity Commission (2005b), "Facts and Figures," http://www.charitycommission.gov.uk,

Chitty, D. and Morgan, N. (2001), "Charities an Industry Accounting and Auditing Guide," London: Institute of Chartered Accountants in England and Wales.

European Commission, (1997). Promoting the role of voluntary organizations and foundations in Europe. Luxembourg, Office for Official Publications of the European Communities.

Doupnika, T.S., and E. L. Riccio (2006). "The influence of conservatism and secrecy on the interpretation of verbal probability expressions in the Anglo and Latin cultural areas " The International Journal of Accounting 41(3): 24.

Hyndman, N.S. (1990). "Charity accounting: an empirical study of the information needs of contributors to UK fund raising charities," Financial Accountability & Management, 6, pp. 295–307.

Real Decreto 776/1998, de 30 de abril, por el que se aprueban las normas de adaptación del Plan General de Contabilidad a las entidades sin fines lucrativos y las normas de información presupuestaria de estas entidades

Travaglini, C. (2005). Un primo quadro interpretativo per l'analisi dei bilanci delle aziende nonprofit. First European Istr- Emes, Parigi.

Torres, Lourdes & Vicente Pina, (2003), "Accounting for accountability and management in NPOS. A comparative study of four countries: Canada, the United Kingdom, the USA and Spain," Financial Accountability & Management, 19(3),263-285.