

# Improving NPOs' accountability in the enlarged EU: towards a common framework for financial reporting in European NPOs'

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CLAUDIO TRAVAGLINI  
Professor  
Department of Management  
Bologna University  
Rimini Campus  
Piazza Teatini 10  
47900 Rimini  
Italia

claudio.travaglini@unibo.it

## ABSTRACT

Not for Profit Organizations (NPOs) are in the middle of a relevant debate by scholars, politicians and public opinion. Research centers and international institutions made some efforts to measure economic dimensions of "third sector" while there is a remarkable lack of homogeneity concerning NPOs accounting regulation in the European Union.

This paper, wants to highlight, the possible areas of overlap and the coincidence in the accounting models, through the analysis of regulatory pathways for the harmonization of accounting results of the non-profit non-commercial, undertaken by some European countries United Kingdom, Spain and Italy

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.

**KEY WORDS :** *Not for Profit Organizations; Accounting Harmonization, Common Accounting Framework*

## INTRODUCTION

The role of the third sector in the European Community is widely recognized by the Commission and European Parliament<sup>1</sup>, 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 the training and professionalization, and through communications that define the roles and the operability of these entities.

The panorama of the social economy is very heterogeneous, not only in the types of companies and sectors of operation, but also in the way of relationship with civil society, and especially in reporting accounting practices (Jerger and Lapsley, 1998).

The European Commission and Parliament, however, until now, have largely avoided to issue specific rules for the economic and financial reporting applicable to all the 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.

There is a large area of doubt which invests particularly the Associations and Foundations and, more generally, all those companies not incorporated in the form of capital, that makes it difficult to give account and compare the results of these actors' social economy.

The grey area, paradoxically covers just those types of companies that have more pervasive within civil society and that more than others can promote integration among EU citizens.

The enlargement of the Community area 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 of preparation of annual budget, which is common in all European states for actors of the third sector do not conduct in business.

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<sup>1</sup> The importance to the European economy and society of co-operatives, 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>)

The convergence towards a common framework primarily requires an analysis of cultural models (Timothy S. Doupnika and Riccio 2006) and then an analysis of national accounting models. Every single state have given birth to a specific accounting model, we need to highlight the convergence points and possible overlap, and then preparing a common model.

It is therefore vital cultural and legislative analysis of those countries which have launched annual accounting report for those players of the third sector is not constructed in the form of capital. Through these early experiments is therefore possible to derive a path for the creation of a single and united accounting model.

This paper, wants to highlight, the possible areas of overlap in the accounting models, through an analysis of regulatory pathways for the harmonization of accounting results of the non-profit non-commercial, undertaken by some European countries United Kingdom, Spain and Italy.

## **AN INITIAL COMPARISON**

A possible confrontation between national models reports can be conducted by analyzing the legislative sources involved to define the rules for accounting report of non-profit entities .

The accounting reports for a nonprofit aims to inform the stakeholders about the institutional mission and the means by which the company has used the resources in carrying out its activities, considering how these resources can be acquired and used other than pure economic exchange. (Travaglini 2005)

Although the comparison can only start from an analysis of the rules on reporting accounting, it must be, as pre requirement, the reconnaissance scientific output, which help to understand the individual national models, the procedures for training, identification and to built a possible model for comparison.

The comparison should highlight the possible connections and overlaps in the way of informing the stakeholders on achieving institutional mission and representation of the results achieved.

The comparison between the methods chosen by each state to represent the purpose and the object of accounting reports of non-profit entities, must also highlight the technical process of formal accounting of the individual prospectuses, and the integration in the model of any national accounting and / or international principles and procedures for making public the results achieved.

From a primary reconnaissance of the rules of individual European countries can be seen as the process of harmonization of accounting information, for businesses of the third sector, is following in Europe different speeds. There is, however, the uniform intention to lead to a document reporting implemented with national accounting standards or principles, a model that allows to non-commercial not profit entities to disclose economic performance. There is a partial distrust towards the integration in the models of accounting for non-profit entities with international accounting standards, more fruitful could be to create a accounting framework rather than convergence with IAS IFRS.

Some national bodies, responsible for harmonization of accounting reporting of non-profit entities, seem to be aware of the need to make it more transparent and useful information concerning the management of companies, and intending to lead in the long run to a common model, a model that can be represented by a convergence towards a specific national regulation or a new accounting framework.

Instead of the European Commission and Parliament, the individual states, appear to be oriented to define, starting with a national scheme, a model that in the long run can afford the general comparability of findings.

The path followed at the level of individual nations, however, raises some questions of substance, pursue a path of harmonization of accounting reporting through the implementation of accounting both national and international, born in scope for profit may be an appropriate harmonization of accounting or longer think of a proper path totally autonomous integrated at Community level?

Waiting to find an adequate response to earlier questions, we try to compare three different national models, three different ways to interpret and harmonize accounting information of non-profit, three different attempts to respond to needs of non-profit companies not commercial.

The three regulatory systems are comparing the UK, the most complete and run over time, the Spanish which derives the information for non-profit companies through an adaptation of national accounts and Italian who is still at an early stage .

The United Kingdom has a centuries-old history of regulating non-profits, dating back to 1601 the "Statute of Charitable Useses" the first law of organizing the activities of these institutions and to the 1853 establishment of Charity Commission who had and the purpose of regulation and control over the third sector.

But in reality as stress Chitty & Morgan, (2001) "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" (quoted in Cordery & Baskerville, 2007, p.11)

Today, the economic and financial reporting of non-profit entity 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 that goes forward from 1988<sup>2</sup>. It took several adjustments to adapt the model of reporting to the real needs of non-profit entities and to bring it into line with all the different accounting standards and financial institutions present in the United Kingdom. The SORP currently in force is the result of a profound dialogue between the members of Charity Commission and the Accounting Standards Board, the two entities have therefore tried to unite the real needs of non-profit companies with national standards of accountability, drawing up a document detail. The interaction has resulted in a model of reporting comparable throughout the UK, also based on accounting standards for small businesses that refer to specific International Accounting Standard.

The purpose of the adoption 'Accounting and Reporting by Charities: Statement of Recommended Practice, is to give a clear and transparent representation of activities and financial position of non-profit entities which have an annual income exceeding £ 100.000,00. The charity Commission wants to say, through the SORP, the possibility to compare the results and activities of companies operating within the national territory, and to give to operators a guide that is a valid model for the compilation<sup>3</sup> of accounting documents in UK<sup>3</sup>.

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<sup>2</sup> For the evaluation of the various impacts of regulation on British charity, please refer to research Bird & Morgan-Jones 1981, Ashford 1989, Gambling, Jones, Kunz & Pendlebury 1990, Hines & Jones 1992, Williams & Palmer 1998, Connolly & Hyndman 2000 .

<sup>3</sup> 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)

The model of "Annual Report" that the SORP proposes is the set of a series of quantitative information such as describing the evolution of the non-profit during the accounting year of reference.

The SORP Annual Report must include:

- a) Reference and Administrative Details of the Charity, its Trustees and Advisors: A series of specific information needed to identify not only the non-profit, but also its directors, and also any independent or dependent auditor
- b) Structure, Governance and Management: The non-profit entity must be a clear not only the internal organization, but also motivate the choice of legal form (limited company; unincorporated association; trustees incorporated as a body) and the internal rules decision and to vote.
- c) Objectives and Activities: the institution must highlight what are the objectives of charity, what is the role of charity and by what methods it pursues its activities.
- d) Achievements and Performance: The activities must also be illustrated through performance indicators or sectoral comparisons, to highlight the reader of the role and importance of non-profit. They must also be exposed in this section the results and activities found raising undertaken and the results obtained from these campaigns.
- e) Financial Review: In this section should be presented the financial position of the entity and should be explained the reserves and the change that occurred over the previous period, giving appropriate reasons for such variation
- f) Plans for Future Periods: shall be presented the objectives and plans for the next accounting year.
- g) Statement of financial Activities: The document, purely accounting, seeks to highlight how the company has used, in relation to the stated objectives, its resources. The model is designed in the form stairs, according to a logic of cash.
- h) Balance sheet: This document allows to disclose the assets and liabilities highlighting the consistency of the assets. As part of the equity the SORP include intangible assets.

- i) Cash Flow Statement: The document supplementing the Statement of financial Activities, giving an appropriate representation of cash flows, highlighting the origin and use
- j) Notes on the accounts: the rules should be highlighted followed in the preparation of accounts, the accounting standards used and how they were interpreted.

The document is then drawn up under the supervision of auditors which 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 to the not profit entity. That difference set by law depends on the income levels of non-profit, based on the following schedule:

Gross Income of Charity	Minimum Permitted Scrutiny of Accounts
< £10,000	Approval of accounts by trustees only - no external scrutiny require
£10,000 to £250,000	Independent examination by an examiner of the charity's choice
£250,000 to £500,000	Independent examination by a professionally qualified examiner
> £500,000	Audit by a registered auditor

**Tabella 1 Source Gareth G. Morgan, 2006**

Once approved by the auditor, the Annual report is lodged at the Charity Commission which shall disclose this information, partly in public partly remuneration.

In Spain the rules of accounting harmonization for non-profit entity was 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, national accounts, and provides an adaptation compulsory for all non-profit entities.

The application of national accounting firms to non-profit has allowed the integration of accounting models with national accounting standards, but omitted that process of comparison with the real needs of non-profit companies.

The model reporting Spanish however is still relatively young to express a real judgment on what is the best operational approach.

The Standard Spanish provides a general scheme for annual accounts for companies that have:

- Value of assets over € 150.000,00
- revenues exceeding € 150.000,00
- An average number of employees exceeding

for institutions that are under these parameters, you would use a model of accountability shortened.

The "model de cuenta anuales", is composed:

- a) Balance: Document drawn up in scale, which account of the balance sheet of non-profit, with appropriate separation of debts of claims and put up the equity.
- b) Cuenta de resultados: Document drawn up in accounting sections divided and opposed. This document try to explain the economic situation of the non profit entity integrating information concerning the receipt and expenditure of money.
- c) Memory: Document being predominantly qualitative they are given not only information relating to the company, administrators and the governing bodies but also are appropriate representation of 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	Annual Report
UK	UK GOV.	1993 Charities Act 1995 Charities (accounts and reports) Regulations 1997 Charities (annual return) Regulations	Accrual (cash accounting is allowed for small entities)	Reference and Administrative Details of the Charity, its Trustees and Advisors Structure, Governance and Management Objectives and Activities

	Charity Commission	1988 SORP Statement of Recommended practice: Accounting by Charities		Achievements and Performance Financial Review Plans for Future Periods Statement of financial Activities Balance sheet Cash Flow Statement Notes on the accounts
		1964 Association Act and the Royal Decree of	Accrual	Statement of financial Activities Balance sheet Notes on the accounts
<b>SPAIN</b>	Spanish Gov.	1994 National Foundations Act		
	AECA	1998 Chart of Accounts ED for the Accounting in NPO's		

**Tabella 2 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.

	<b>UK</b>	<b>SPAIN</b>
<b><i>GAAP and national accounting standards incorporated</i></b>	Accounting standard incorporated: Statements of Standard Accounting Practice (SSAPs); Financial Reporting Standards (FRSs); Urgent Issues Task Force abstracts (UITFs);	Integrations of accounting principles : Principio de Prudencia Principio de entidad en funcionamiento. Principio de Registro. Principio del Precio de Adquisición. El Principio del Precio de Adquisición deberá respetarse siempre. Principio de Correlación de Ingresos y Gastos. Principio de No Compensación. Principio de Uniformidad. Principio de Importancia Relativa.
<b><i>Incorporation of accounting International Accounting Standard</i></b>	Partial (IAS 10, 22, 29, 32 e 39)	In progress

The process of promoting a model of annual report for non-profit in Italy is moving now the first steps, the Italian Agency for Onuls, recently approved the document "Guidelines and schemes for the preparation of balance sheets of non-profit entity". The document is a non-binding nature directed at non-profit with revenues exceeding € 100.000,00 and wants to push bodies to draw up uniform accounts, which also 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 in the shortened version (the accounts of receipts and payments and Notes).

The budget operating in the full version is composed of:

- a) Balance sheet: The document follows the proposed model of the balance sheet for commercial entities, except that commercial entities must get an external audit.
- b) Cash management: The document highlights the result of management through the comparison between income and expense and costs and revenues of competence for the year. As the Spanish model it is in accordance with the principle of competence indicating divided and opposed the sections.
- c) Notes: The document describe the entity, its administrative bodies and Government, changes during the year, as well as highlight the principles adopted for the preparation of the budget itself.
- d) Mission report: The document must give account of the aims of the non-profit, its social mission, the system of values and principles that characterize it, assets and modalities through which should pursue these aims. Furthermore, the document should demonstrate stakeholders engagement.

The guidelines proposed by the Italian government, show less timely and detailed than those of the other two countries taken into consideration, to highlight how the same represent a point of departure rather than arrival.

In the documentary committee Italian, closely follows the structure partly Spanish, but by entering the appropriate differentiation for small businesses, and especially focusing on a special document, the non-accounting information and dialogue with stakeholders, the report of the mission.

By analyzing the procedures of advertising annual report, we must highlight how explicitly mention of such arrangements only in SORP, which track procedures common to all charity. Non-profit entity, located in the Spanish and Italian the same procedures advertising world English, that is a record that captures and advertises the findings accountants. In the two Mediterranean countries there are no mechanisms of disclosure accounting for non-commercial and non-recognized. The common framework and community should therefore also look to define these conditions.

## CONCLUSIONS

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.

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