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# Portraying the Portuguese Foundational Sector: A Financial Statement Analysis

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**Title:**

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**Abstract:**

Foundations' importance in the actual economy has been increasingly recognized. This work project assesses the impact of the new legal framework in the foundations' financial reporting and offers a financial statement analysis of the Portuguese foundational sector. It unveils links between financial performance and characteristics of foundations, and profiles foundations in three clusters, each with different approaches to disclosure, volunteer workforce, and taxes. It is concluded that foundations are not respecting the benefits trusted to them, calling for a tighter control to their financial reporting, and that even though that slowly, the sector is expected to continue growing.

**Key words:** Foundations, Financial Reporting, Financial Analysis, Portugal

## 1. Introduction

*“To give away money is an easy matter and in any man’s power. But to decide to whom to give it and how large and when, and for what purpose and how, is neither in every man’s power nor an easy matter.”*  
- Aristotle

The third sector has been confirming its place within societies as it becomes responsible for a larger amount of economic activity (Franco, 2005). Even though in 2012 it was thought that the number of foundations in activity in Portugal ascended to 831, the census carried in that year under Law Nr. 1/2012, were answered only by 401 foundations<sup>1</sup>. Still, the census revealed that only 358 foundations presented the necessary information on their activities<sup>2</sup> to be considered in the assessment. Since then, the list of foundations operating in Portugal can be found in the website of the Presidency of the Council of Ministers (*Conselho da Presidência de Ministros*)<sup>3</sup>. In a three-year period, from 2008 to 2010, the Portuguese government has attributed subsidies in the value of €1,034 million<sup>4</sup>, an amount which represents one per cent of the Portuguese 2010 GDP<sup>5</sup>. Additionally, although one of the distinctive characteristics of these organizations is the reliance on volunteer worker, in 2010, 34,367 citizens, one percent of the total Portuguese active population<sup>6</sup>, were employed in 346 foundations<sup>7</sup>. The relative importance of the Portuguese foundational sector can also be evaluated by means of the wealth these organizations hold. In 2010, five years ago, Portuguese foundations totaled a wealth of €5,928 million, three percent of the Portuguese GDP.

The data exposed debunks the preconception that the third sector is negligible, even to a greater extent if one considers that the information is not completed, as there are foundations whose

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<sup>1</sup> Relatório de Avaliação das Fundações (2012).

<sup>2</sup> Thirty seven foundations did not answer to a vast number of questions on the census, and six foundations were acknowledged after 2011 or initiated their activity after that date.

<sup>3</sup> <http://www2.sg.pcm.gov.pt/geupf/FullAccess/ListaEntidades.aspx?ReqType=2>

<sup>4</sup> Forty-five per cent of the census’ sample, did not answer this question, meaning the real value must be higher.

<sup>5</sup> The Portuguese GDP in 2010 amounted to €179,929,800,000 (source: Pordata).

<sup>6</sup> The Portuguese active population in 2010 was composed by 5,489,700 individuals (source: Pordata)

<sup>7</sup> Twelve foundations reported having zero collaborators or did not answer this question.

figures were not accounted for in the 2012 census. The census is part of the transparency that characterizes the new regulatory framework of the Portuguese foundational sector. This process of officially counting and recording facts allows assessing the size of the population of Portuguese foundations, and is a tool to collect relevant information on the sample that exercises the duty to answer the census. Still, few publications have been supported on these values, claiming to fill the existing void. Although the focus of foundations is not on profit, their dependence on subsidies and donations gives stakeholders a legitimate claim to access to both financial and non-financial information. Hence, transparency is an issue of the utmost importance for foundations in order to preserve the confidence of the public (Benjamin, 2008).

Thus, the purpose of this Work Project is to assess the Portuguese foundations' reporting and to offer insight into their financial analysis. This research addresses to preparers, highlighting their effort in assuring users of the reliability, relevance, and understandability of the financial statements. However, it contributes mostly to users, exposing relations between variables and quantifying the Portuguese foundational sector.

This work project proceeds as follows. Section 2 introduces the definition of foundation. Section 3 sets the legal framework for governance, taxation, and financial reporting of foundations. Section 4 reviews prior literature. Section 5 outlines the research questions, methodology, and the sample. Section 6 explores the questions, and discusses the results and possible implications. Section 7 resumes the main conclusions, contributions, and suggestions for future research.

## 2. What is a foundation?

The third sector comprises organizations which pursue, mainly, nonprofit activities and, accordingly, do not distribute profits to their stakeholders. Non-profit organizations (NPOs) may assume the form of associations, federations, and, among others, foundations<sup>8</sup>.

Although there is no consensus on the definition to adopt, it has been accepted that the main distinctive characteristic between foundations and profit-seeking organizations deals with profit accumulation. While profit-seeking organizations' main drive is that of maximizing profit to be distributed among its owners, foundations' main concern is that of facilitating well-being and social development. Further distinctions between the two types of organizations can be found considering revenue and financing sources. Foundations do not sell goods nor do they render services as a primary source of wealth creation. Rather, foundations' financing is dependent on subsidies and donations, which creates an additional pressure on these organizations to reveal their financial records to the public.

In Portugal, foundations are defined by means of the Civil Code (*Código Civil*) and Foundations Framework (*Lei-Quadro das Fundações*) as collective persons, possessing a set of assets to be used in the pursuance of not profitable activities of general interest to the society. The United Nations provides several recommendations and an international classification for NPOs based on their main activity (UN, 2003). In Portugal the economic activities are classified by means of the code of economic activity (*Código de Actividade Económica*, CAE).

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<sup>8</sup> All NPOs share the non-pursuance of profit accumulation and non-distribution of profit, the predominance of subsidies and donations as a form of income, as opposed to sales or rendering of services, and the preference for volunteer workers rather than paid workers. Within the third sector, foundations distinguish themselves from other NPOs as they have to manage an initial endowment throughout the years, as opposed to receiving regular and predictable cash inflows from members.

### 3. Legal Framework

The Portuguese legal framework for foundations is three-fold: it includes issues of governance, tax regulation and financial reporting.

#### 3.1 Governance and Taxation

Since 2012, following the approval of Law Nr. 24/2012, the *Lei-Quadro das Fundações* (LQD) has regulated Portuguese foundations, amending the Portuguese Civil Code, which had been in force since 1966<sup>9</sup>. LQF establishes the requisites that should guide the formation and acknowledgement<sup>10</sup> of foundations, as well as the general rules concerning their organization and functioning. Law Nr. 24/2012 imposed a tighter control to any situation that involves the use of public funds. In light of this, it set the transparency practices that every foundation must comply with, namely the obligation to send to the government departments their annual reports, while making them also available through their websites. Hence, the government is able to keep an updated database with the information it deems relevant.

Depending on the legal personality of its founders, a foundation may be classified as public, private or private with public right<sup>11</sup>. Foundations may also apply for a public utility statute<sup>12</sup>, a statute attributed to foundations which pursue an end of special relevance for society. This statute as well as that of private social solidarity institution (*Instituição Particular de Solidariedade Social*, IPSS)<sup>13</sup> confer exemption from income tax (*Imposto sobre o Rendimento das Pessoas Colectivas*, IRC). Therefore, transparency is of the utmost importance to justify the tax

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<sup>9</sup> Articles 158<sup>th</sup>, 162<sup>nd</sup>, 166<sup>th</sup>, 168<sup>th</sup>, 185<sup>th</sup>, 188<sup>th</sup>, and 190<sup>th</sup> until 194<sup>th</sup> of the Portuguese Civil Code, approved by the Decree-law Nr. 47 344, were altered by the Law Nr. 24/2012.

<sup>10</sup> The acknowledgment of private foundations is of the responsibility of the Portuguese Prime Minister.

<sup>11</sup> Article 4<sup>th</sup>, LQF.

<sup>12</sup> Foundations must fill in for this statute that is to be attributed by the Portuguese Prime Minister. Collective persons with the statute of public utility are exempt from IRC under the Decree-law Nr. 460/77.

<sup>13</sup> Article Nr. 10<sup>th</sup> of the CIRC (Code of Corporate Income Tax). IPSS face additional reporting obligations towards the Ministry of Labor and Social Security (*Ministério do Trabalho e Segurança Social*), which fall out of the scope of this Work Project.

exemptions. For the case of non-exempted foundations, corporate income tax is assessed on the global income (taxable income), which is taxed at a 21.5 percent flat rate<sup>14</sup>.

Foundations are obliged to have an administrative board responsible for managing the initial endowment, an executive board to deal with every-day management of the foundation, and an audit board in charge of auditing the annual accounts<sup>15</sup>. An Advisory Body (*Conselho Consultivo das Fundações*) exists and is available to assist foundations understanding the application of the LQF, and any issue foundations believe is not accounted in that framework.

Each foundation formed for a predefined period of time is required to have a minimum initial funding of €250,000 to ensure ability to fulfill its activity<sup>16</sup>. Additionally, foundations may also be requested to have their accounts legally certified by an external auditor<sup>17</sup>.

### **3.2 Financial reporting standards**

In Portugal, until March 2011 specific accounting regulations for foundations were nonexistent. Since then, the Decree-law Nr. 36-A/2011, known as SNC-ESNL (*Norma Contabilística de Relato Financeiro do Setor Não Lucrativo*), sets the financial reporting standards that foundations operating in Portugal must comply with<sup>18</sup>. These standards are an adaptation of the international financial reporting standards (IFRS/IAS) to the NPO sector<sup>19</sup>.

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<sup>14</sup> Cf. CIRC, Article 87<sup>th</sup>. Organizations may be able to deduct their losses as long as the categories are respected – a loss in one of the income categories can only be deducted from the income arising in that same category – up to a limit of 75 percent of the taxable income. Some types of income are exempt from taxation. Under article 54<sup>th</sup> of the CIRC, from 2014 onwards, increases in assets, obtained for free, to be used in the pursuance of the foundations' main activity are exempt from IRC.

<sup>15</sup> Articles 26<sup>th</sup> to 30<sup>th</sup> of LQF.

<sup>16</sup> Additionally, every foundation must have at least 30 per cent of its initial endowment, and never less than €100,000, in the form of cash (Article 2<sup>nd</sup> and Article 3<sup>rd</sup>, Ministerial Order Nr. 75/2013).

<sup>17</sup> According to article 12<sup>th</sup> of the Decree-law Nr. 36-A/2011 foundations presenting consolidated accounts and surpassing the size limits referred to in article 262<sup>nd</sup> of Companies Business Law (*Código das Sociedades Comerciais*, CSC) – €1,500,000 in total assets, €3,000,000 in sales turnover, and 50 employees.

<sup>18</sup> These are dependent on the size of the foundation, its type, and or not it belongs to a group. Moreover, this set of financial statements represents the minimum disclosure to which foundations are subject; they voluntarily can disclose additional information.

<sup>19</sup> Still, IFRS requires more extent disclosures than SNC-ESNL; IFRS 23 indicates that financial assets and liabilities are to be recognized at fair value, while NCRF 10 allows for reevaluation; IFRS 20 dictates that grants may be presented as deferred income or by deducting the grant from the asset's carrying amount, while NCRF 22 commands to register subsidies as part of equity and allocated to the current exercise income.

In conformity to the Decree-law Nr. 36-A/2011<sup>20</sup> foundations operating in Portugal ought to prepare annually<sup>21</sup>, a balance sheet, an income statement (by nature or by function), a statement of cash flow, and also notes to accompany the report<sup>22</sup>.

The new regulation mandating the preparation and disclosure of harmonized financial statements, allows for a greater availability of data and comparisons. Hence, if correctly enforced, the new legislation allows for financial analysis.

#### **4. Literature Review**

Some authors believe that organizations willing to disclose their financial statements are signaling their intent to accommodate public and private interests in their normal activities (Fremont-Smith, 2007). Thus, it is in the best interest of these organizations to divulge, in their annual reports, all the information that their stakeholders might want to access (Behn, et al., 2007; Monika, 2010). There is evidence that financial accounting can be used to directly impact an individual's giving decision (Krishman, et al., 2004; Parsons, 2007; Augusto, 2014).

Nonetheless, in many cases, this does not occur. Foundations continue hesitant to reveal their financial records under the pretext that the standards used by their profit generating counterparts do not adequately capture their nature (Keating & Frumkin, 2000; Jegers, 2009). Travaglini (2008a) attributes the lack of financial statement regulation on NPOs to the fact that these organizations do not distribute profits, and the belief that due to that it is not necessary to regulate these organizations. Accordingly, until the present time, countries have had to rely on themselves to create and adopt the standards they see fit (Travaglini, 2008b).

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<sup>20</sup> For the periods after 2012 onwards, the financial statements that foundations are obliged to prepare are regulated by means of the Ministerial Order Nr. 105/2011, while the respective code list of accounts to be followed can be found in the Ministerial Order Nr. 106/2011.

<sup>21</sup> Article 11<sup>th</sup>, Decree-law Nr. 36-A/2011.

<sup>22</sup> Small foundations with an annual revenue below €150,000 may adopt the cash basis accounting (*regime de caixa*) in spite of accrual basis accounting. These foundations need only to report in an abridged format, which includes no more than a list of payments and receipts, a list of fixed assets, and a summary of future commitments related to assets and liabilities. Foundations can voluntarily adopt the SNC-ESNL since it was created in 2012.



The consequent scarcity of available data may justify that few studies have been carried and published to date<sup>23</sup>. In fact, few empirical research on foundations exist, most of the existing studies are normative. Most of the existing literature on foundations describes the regulations and conditions in which these are applicable, while offering opinions and critics on it. Moreover, the majority of existing literature takes the third sector as a whole ignoring the variety in the organizations that make up this sector.

Trussel and Parsons (2004) identify the factors affecting donors' decision to give. Their research has proven useful for researchers interested in NPOs' accounting and financial reporting, and donors in the evaluation of such statements. Drucker (1989), notes that a clearly defined mission helps others understanding their purpose, which in turn has the potential to instill donors to give. Michalski (2012) analyzes financial indicators for Polish NPOs. The author focused on liquidity and efficiency indicators, and the relation between them, recognizing that liquidity is vital to stay in business, and the need to efficiently use the resources of nonprofits.

Most of the publications with a scope limited to foundations focus on legal aspects, tax issues, or the qualitative characteristics of the financial records. Gomes and Pires (2014) present a normative exposure of the LQF and its implications. Additionally, among the most relevant works on foundations in Portugal is "The Portuguese Non Profit Sector in Comparative Perspective" from the *John Hopkins Center for Civil Society Studies*, a study providing the bigger picture of the civil sector in Portugal, and an analysis as to how it compares to other countries. However, this is not specific to foundations.

Also relevant to foundations is the research by Carvalho (2014), who studies the variables that impact the decision to voluntarily disclose financial information. This study takes is based in information disclosed after the enforcement of the LQF rendering it a pertinent development from

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<sup>23</sup> Journals dedicated to the NPOs are scarce – the most relevant being *Voluntas*, the *International Journal of Non Profit and Voluntary Sector Marketing*, the *Nonprofit and Voluntary Sector Quarterly*, and the *Journal of Nonprofit & Public Sector Marketing*.

Coelho (2010) – the first research on financial reporting by foundations in Portugal to the best of our knowledge. These studies focus on the preparation of financial reports, but not in uses of these reports in financial analysis. Notwithstanding, this Work Project aims at fulfilling the void of the still unaddressed need of the stakeholders of Portuguese foundations, answering to the efforts of *Centro Português de Fundações* (CPF, 2014)<sup>24</sup> to create all the conditions that allow this study, namely the availability of more comparable information on Portuguese foundations. This research addresses to preparers, considering their effort in assuring users of the reliability, relevance, and understandability of the financial statements, and to users, analyzing such data, while unveiling communalities between foundations, and thus creating profiles. This study updates Coelho's research (Coelho, 2010) by considering the new regulation that applies to the financial reporting of foundations Portuguese, and additionally it completes both Coelho (2010) and Carvalho (2014) researches' by adding financial analysis.

## **5. Methodology**

### **5.1 Research Questions**

This paper aims at characterizing both financial reporting and financial analysis in the foundational sector in Portugal, and finding profiles according to certain characteristics, using cluster analysis. Considering this, the research questions are divided into three groups: the first deals with the preparers' perspective over the existing financial reporting, the second focuses on the users' perspective that is financial analysis, which of course is limited by what preparers do, and finally, the third considers the variables analyzed in the previous research questions to group foundations in coherent clusters.

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<sup>24</sup> CPF 2014 Annual Report.

Three questions are addressed in view of characterizing the financial reporting by Portuguese foundations.

RQ 1: *Which financial reporting standards are Portuguese foundations adopting?*

RQ 2: *Which financial statements are Portuguese foundations presenting?*

RQ 3: *Are Portuguese foundations having their accounts legally certified?*

The results obtained are compared to those reported by Coelho (2010) in order to conclude on the evolution of the financial reporting prepared by Portuguese foundations in what concerns harmonization, transparency, and reliability. Additionally, the answers validate the hypothesis that it is possible to go further on the subject and approach financial analysis.

RQ 4: *What are the foundations' resources and sources of capital?*

RQ 5: *How do foundations generate value?*

RQ 6: *How has the foundational sector evolved and what to expect in the future?*

The second group of research questions (RQ 4, RQ 5 and RQ 6) focus mostly on the activities in which the foundations engage and their financing, both strongly related to the non-pursuance of profit that defines foundations. Moreover, attributes such as the public utility statute, IPSS recognition, and code of economic activity, discussed in the descriptive analysis of the data, are considered in determining the extent to which those are related to the topics being discussed under each question. The size, activity, financing sources, and value creation variables will be used to find possible clusters.

RQ 7: *Are foundations grouped around key variables?*

The questions on financial reporting (RQ1, RQ2 and RQ3) are answered with univariate analysis as they deal mostly with the description of the sample and can be understood as exploratory data analysis. On the other hand, the questions on financial and cluster analysis (RQ 4, RQ 5, RQ 6 and RQ 7) are answered with bivariate analysis, making use of double entry tables, computing correlation coefficients, differences in means, and clusters. Considering the size of the sample,

the statistical tests were carried, with a defined threshold for the significance at  $\alpha \leq 0.1$ . In the three sets of questions, foundations' financial data is analyzed using common-size figures and other ratios in order to eliminate the size effect and make data comparable.

## 5.2 Sample

The initial sample included all the foundations in activity in Portugal<sup>25</sup> as it is available for consultation in the website of the Presidency of the Council of Ministers. This list was filtered so as to include in the present study only the foundations currently active and acknowledged by the Prime Minister. According to the LQF these foundations must make their financial statements public through disclosure in their websites. However, from the initial sample of 328 foundations, only the websites of 238 (73%) of those foundations, roughly, were found in online searches, further reducing the number of foundations to include in the final sample. Hereinafter, the websites were searched for the financial statements. Only foundations with financial statements pertaining to the most recent fiscal year, that is 2014, are included in the research. The LQF was only put in force in 2013, meaning that foundations are required to disclose their annual reports for the year 2012 onwards. However, there was an initial period in which few foundations adopted the new law, 2014 is the year in which a larger number of foundations are abiding to the law. Moreover, only foundations with both the balance sheet and income statement made publicly available are accounted for<sup>26</sup>, leaving 88 foundations (appendix 1) to be considered in the final sample, whereby the statistics computed will have an associated level of precision of approximately 9%<sup>27</sup>. The information concerning these foundations was hand collected from each

<sup>25</sup> This research uses a convenience sampling.

<sup>26</sup> These are the main financial statements from which data was collected. Additionally, foundations not disclosing the notes for their financial statements nor any accompany report on the financial results are not considered as it is not possible to understand the scenario the accounts describe.

<sup>27</sup> Considering a population of 401 foundations, a sample of 88 foundations, maintaining a confidence level of 95%, under a pessimistic scenario in which the population has maximum dispersion, with  $p=0.5$ :

$$D = 1.96 \sqrt{\frac{0.5 \times (1 - 0.5) \times (401 - 88)}{401 \times 88}} = 0.9$$

foundation's website and comprised in an Excel database with 88 observations and 34 variables<sup>28</sup> (appendix 7). This data was statistically tested using SPSS version 23.

### 5.3 Data Analysis

The foundations have a minimum age of one year and a maximum of 82 years<sup>29</sup>. The majority of the foundations (80%) has been in activity for up to 30 years.

Out of the 88 foundations considered, 32 (36%) are IPSS, and 78 (90%) have public utility status. Still, no relation exists between the two conditions<sup>30</sup>, meaning that the fact

		IPSS		
		Yes	No	
Public Utility	Yes	30 (34%)	48 (55%)	78 (89%)
	No	2 (2%)	8 (9%)	10 (11%)
		32 (36%)	55 (64%)	88 (100%)

Table 1. Foundations' characteristics

that one foundation benefits from one of the statutes does not permit to infer on the second statute. As both statutes confer tax exemptions, there are 80 (90%) foundations which benefit from income tax exemption. Only a minority of circa 10% foundations paid income tax in 2014.

Using total assets as a proxy for size, Portuguese foundations' size ranges from €90,356, for *Fundação GDR*, up to €3,199,318,000, for *Fundação Calouste Gulbenkian*, which represents 67% of the sectors' total assets. The average size of foundations is €54,029,582<sup>31</sup>. Despite

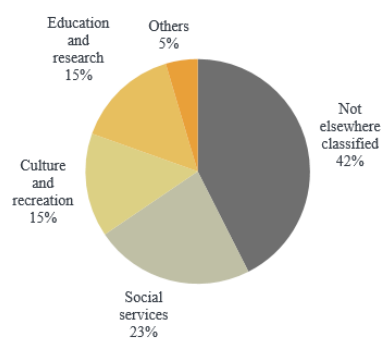


Chart 1. Activities of Portuguese foundations according to the UN classification

disparity of size, there is no significant correlation between size and being IPSS or having the public utility status<sup>32</sup>.

Classifying these foundations by their main activity<sup>33</sup>, most of the foundations (42%) engage in associative activities. Nonetheless, within the selected sample there are 25 different codes of economic activity (CAE). Based on these codes, the

<sup>28</sup> The initial dataset was comprised by 88 observations and 84 variables.

<sup>29</sup> Foundations' ages were analyzed in four intervals corresponding to the percentiles: [1; 10], [11; 20], [21; 26], and [27; 82].

<sup>30</sup> The independency *t*-test is not significant (sig=0.380).

<sup>31</sup> The median is €5,331,327, suggesting considerable dispersion among the foundations regarding size.

<sup>32</sup> The correlation coefficients between the size and the IPSS and public utility statutes are not significant (sig=0.164 and sig=0.259, respectively).

<sup>33</sup> Foundations main activity was determined based on their code of economic activity.

foundations' activities were then recoded so as to follow the classification proposed by the United Nations Handbook on Non-Profit Institutions (appendix 3). In light of this, it is possible to note that the sample is composed by very diverse foundations (chart 2).

## 6. Results

### 6.1. Financial reporting

#### *Financial reporting standards (RQ 1):*

In 2014, the vast majority (99%) of the Portuguese foundations report according to the domestic accounting standards, defined in the SNC-ESNL. Only one foundation, *Fundação Calouste Gulbenkian*, adopts the international financial reporting standards IFRS/IAS in its financial reports. Coelho (2010) noticed that in 2009 Portuguese foundations adopted three different financial reporting standards<sup>34</sup>. Presently, financial reporting by foundations is more harmonized, and thus allows for comparisons and financial analysis.

#### *Financial statements (RQ 2):*

With the exception of *Fundação Calouste Gulbenkian*, which presents both consolidated and individual accounts, all foundations only present individual financial statements. According to Decree-Law Nr. 36-A/2011, foundations are required to present a set of four financial statements. Nonetheless, only 64

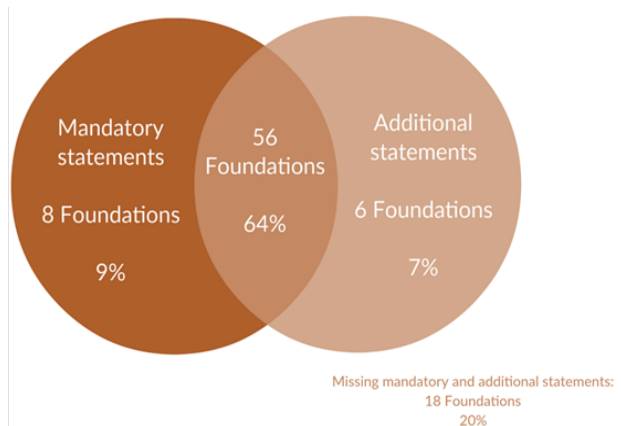


Chart 2. Financial reporting presentation

(73%) foundations disclose all the required information, and 62 (70%) present a statement beyond those that are mandatory, the statement of changes in equity (chart 2). There are eighteen (20%) foundations not presenting the beyond mandatory statement of changes in equity of which, six

<sup>34</sup> 72% of foundations were using POC, 24% were reporting according to PCIPSS, and one foundation, *Fundação Calouste Gulbenkian* adopted IAS/IFRS

(7%) do not present the statement of cash flows nor notes, ten (11%) fail to disclose the statement of cash flows, and two (2%) are also missing the accompanying notes. Also evolution from Coelho (2010) can be noted as the percentage of foundations presenting the statement of cash flows has registered an increase, from 50%, in 2009, to 77% in 2014.

As expected, there exists a positive correlation between the number of statements presented and the length of the annual report ( $p=0.300$ ,  $sig=0.004$ ). But no evidence is found that IPSS or public utility foundations tend to present incomplete financial statements ( $p=0.263$ ,  $sig=0.013$  and

		IPSS	
		Yes	No
Public Utility	Yes	29	34
	No	2	4

$p=0.177$ ,  $sig=0.099$ , respectively). These

results are alarming as these statutes confer

tax exemption; foundations benefiting from

Table 2. Number of foundations not paying taxes by statutes

such statutes should be bound to respect tighter controls assuring the disclosure of financial information.

*Legal certification (RQ 3):*

According to the exposed in section 3 on governance, none of the foundations is legally required to have their accounts certified, but *Gulbenkian*. Notwithstanding, there are 49 (56%) foundations divulging the legal certification of the 2014 annual accounts. It is commendable that even though the foundations are not legally obliged to submit their accounts to legal certification they opt to do so. Such practice confers more reliability to the figures reported.

What is more, there exists a positive association between the disclosure of the complete set of mandatory financial statements and having the accounts legally certified ( $p=0.324$ ,  $sig=0.002$ ).

## 6.2. Financial Analysis

### *Resources and sources of capital (RQ 4):*

The balance sheet shows an organization's financial position at a given point in time.

Liabilities, the organizations' obligations to creditors, and the equity, the organizations' net worth, are very similar within the Portuguese foundational sector. The debt-to-equity of the sector is 23%, revealing that foundations resort very limitedly to debt. This is partially the result of

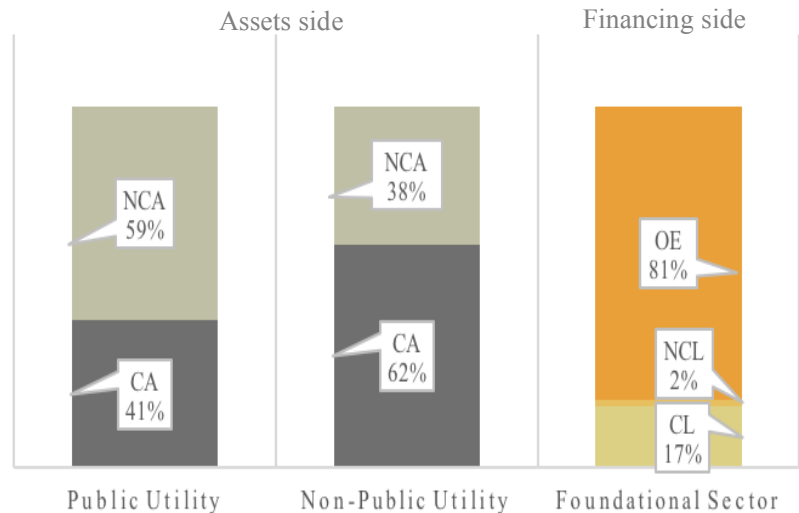


Chart 3. Average common-sized balance sheets for the Portuguese foundational sector

foundations being founded with an initial endowment made of a legacy or donation, and not borrowings. Still, there is one foundation, *Fundação do Desporto* with negative equity (-€171,656), a public foundation.

On the other hand, on the left side of the balance sheet, the investments made by the foundations, are not equal across the sector. Statistical evidence points to the existence of two common-sized investment patterns: one for foundations with public utility status, another for foundations without such status (sig=0.071 for both current and non-current assets). Even though both balance sheets present a favorable short-term position, as current assets are larger than current liabilities in both scenarios, foundations with public utility status, on average, have more non-current assets as a percentage of total assets<sup>35</sup>, and consequently less current assets, than foundations without this statute (chart 3). Thus, public utility foundations have a less favorable short-term financial

<sup>35</sup> The association between public utility foundations and non-current assets is confirmed by a significant correlation coefficient (p=0.194, sig=0.071).



position. Public utility foundations' average current ratio is 2.4 while the same ratio for non-public utility foundations is 3.6. The quick ratio offers a similar conclusion: it is lower for public utility foundations than non-public utility, 1.6 and 2.9, respectively. Even not accounting for the inventories, foundations envisage a favorable short-term position, demonstrating that foundations do not maintain much inventory<sup>36</sup>. Both liquidity measures are greater than one for the two groups, signaling that the entire Portuguese foundational sector has enough resources at its disposal to meet its current obligations.

Considering this, public utility foundations, being less liquid are more stable in the long-run. In fact, the public utility statute on the origin of two average balance sheets is significantly correlated with the age of foundations ( $p=0.188$ ,  $\text{sig}=0.080$ ), reinforcing their strength. Additionally, non-current assets are negatively correlated with the UN classification for NPOs ( $p=-0.208$ ,  $\text{sig}=0.052$ ). As public utility foundations on average have more non-current assets than the remaining foundations, public utility foundations operate mostly in the culture and education fields. Still, there is no relation between the public utility status and the EBIT<sup>37</sup>.

#### *Value creation (RQ5):*

To pursue their objective, often, foundations make use of volunteer workers. In fact, this is one of the specificities of foundations. However, it is not possible to ascertain the number of volunteers used as opposed to paid workers. As such, cost associated to collaborators was analyzed, assuming that foundations with the higher costs employ more paid workers. In 2014, wages ranged from €0 to €23,150,886.

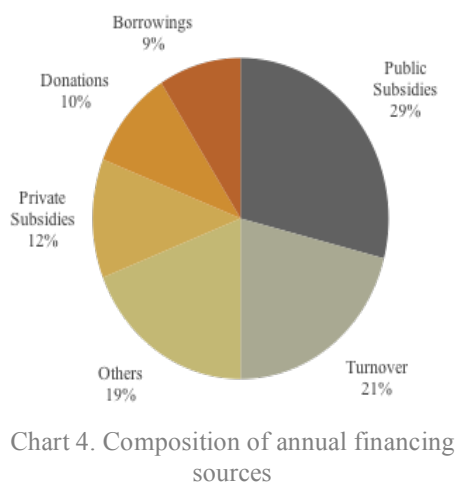
The main source of annual revenue for foundations lies on subsidies and donations<sup>38</sup> (chart 4). On average, subsidies, both public and private, and donations from individuals represent 56% of

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<sup>36</sup> Accordingly, foundations have low levels of inventory: its average is €289,706, with 37 (42%) foundations not registering any inventory, while only 10 (11%) foundations report to have inventory levels above average.

<sup>37</sup>  $p=0.006$ ,  $\text{sig}=0.955$ .

<sup>38</sup> *Gulbenkian* presents a very particular financing model: it does not receive subsidies or donations, nor does it sell goods or render services; rather its financing originates in financial gains: a revenue model significantly different from that predicted in the definition of foundation, hence, it will not be considered in this analysis.



the results of the EBIT ( $p=0.290$ ,  $\text{sig}=0.007$ ). Donations from individuals are not related with any specific variable<sup>42</sup>, suggesting they are based on the subjective preferences and ties donors may have to specific foundations. Hence, public bodies are more concerned with the work foundations develop and their procedures, while private institutions care mostly about the performance of foundations, even though these are nonprofit organizations.

Considering that the goal of foundations is not to attain profit, the net income of organizations does not present to be relevant. Rather, by analyzing EBIT it is possible to better capture the result of their activities<sup>43</sup>. Forty-nine (56%) foundations had a negative EBIT, and consequently had to resort to equity to finance their activities. The remaining thirty-nine (44%) foundations achieved a positive EBIT. In this case, the EBIT was used to pay for taxes and financial costs, and the amount left corresponded to the net income. As, on average, sales and services account only for 21% of total income, and operational subsidies represent 65% of total revenue, results would be even more negative if the operational subsidies were not considered.

foundations' total financing in 2014<sup>39</sup>. If in the one hand public subsidies are correlated with the foundations' size ( $p=0.425$ ,  $\text{sig}=0.000$ ), its main activity ( $p=-0.211$ ,  $\text{sig}=0.050$ )<sup>40</sup>, and legal certification ( $p=0.231$ ,  $\text{sig}=0.032$ ). On the other hand, public subsidies are not correlated with the existence of links with corporations<sup>41</sup> nor with the IPSS statute. Private subsidies are correlated with

<sup>39</sup> Funds received by means of public subsidies, private subsidies and donations from individuals, on average, represent 18% of total assets.

<sup>40</sup> Foundations with the lowest UN code of activity receive more public subsidies. This is a rather anticipated result provided that the highest UN code stands for "others". This means that foundations engaged in culture, recreation, education, health, social services, and environment receive more public subsidies in this order.

<sup>41</sup>  $p=-0.046$ ,  $\text{sig}=0.674$ , and  $p=0.003$ ,  $\text{sig}=0.977$ , respectively.

<sup>42</sup> Foundations' size, IPSS and public utility statutes, UN classification for NPOs, legal certification, corporate links and the disclosure of the complete set of financial statements were tested for correlation with donations.

<sup>43</sup> The EBIT earned in the year 2014 averaged -€632,065, whilst the median was -€5,609.

*Evolution of the foundational sector (RQ6):*

Foundations cannot rely on regular and predictable cash inflows to sustain themselves; rather they have to manage an initial endowment in a way that ensures them the ability to continue carrying on their activities. Comparing the initial endowment to the actual value of equity, the Portuguese foundations have been evolving (chart 5). In 2014, the average annual growth rate for the Portuguese foundational sector was 5%. Thus, on average, foundations have been able to manage the initial endowment with which they were empowered and actually increase the value they have at their disposal for pursuing their activities<sup>44</sup>.

$$\text{Foundational Sector Growth} = \left( \frac{\text{Equity}_{2014}}{\text{Initial Endowment}} \right)^{\frac{1}{\text{Age}}} - 1 \quad (1)$$

This rate is positive for 69 (78%) foundations, while for 18 (20%) it is negative. *Fundação dos Salesianos*, which has been in activity for three years, shows the highest average annual growth (71%), and *Fundação de Arte Moderna e Contemporânea*, with nine years of activity, has the lowest average annual growth (-37%).

Comparing equity on the end of year 2014 with the average initial endowment, the foundational sector has grown by €32,489,721. Analysing the compounded average growth of the Portuguese foundational sector, computed as follows, it is positive in 217%<sup>45</sup>.

$$\text{Average Foundational Sector Growth Rate} = \frac{\text{Average Equity} - \text{Average Initial Endowment}}{\text{Average Initial Endowment}} \quad (2)$$

There is no statistical evidence that the growth rate and the statutes (IPSS and public utility) or age are related. Rather, the compounded growth rate of the Portuguese foundational sector is

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<sup>44</sup> In 2014, the Equity of *Fundação do Desporto* was negative on the end of year 2014, as such it was not considered in for the calculation of the average annual growth rate.

<sup>45</sup> *Fundação Rangel de Sampaio* (225,838%), and *Fundação da FCUL* (153,798%), both IPSS, that have been in activity for 52 and 21 years, respectively. On the contrary, *Fundação do Desporto* (-104%), and *Fundação Axa* (-100%), were the ones with the lowest growth, both with the public utility statute, and in activity for 20 and 16 years, respectively.



Chart 5. Comparison of average initial endowment and average equity

significantly correlated with the existence of a corporate link ( $p=0.190$ ,  $\text{sig}=0.076$ ) and the revenue concentration index ( $p=0.279$ ,  $\text{sig}=0.008$ )<sup>46</sup>. Considering that foundations with the highest equity growth are also the one with the highest revenue concentration index, their growth is not stable. This growth is based on few revenue sources, leaving these foundations vulnerable to shocks in those revenue sources in which they are the most dependent on. Also, a significant positive correlation coefficient between this growth and the EBIT ( $p=0.183$ ,  $\text{sig}=0.088$ ) suggests that those foundations with the highest growth are the same foundations with the highest EBIT, as expected. In turn, foundations achieving the highest EBIT are the foundations receiving more funds from the sale of goods ( $p=0.394$ ,  $\text{sig}=0.000$ ), and receiving the least from the rendering of services ( $p=-0.279$ ,  $\text{sig}=0.009$ ), and public subsidies ( $p=-0.256$ ,  $\text{sig}=0.009$ ), as a percentage of total assets. Hence, foundations exhibiting the greatest equity growth have higher EBIT, powered mostly by means of the sale of goods, which causes them to be too dependent on this revenue source.

Keeping in mind that foundations do not distribute dividends (and hence, the payout ratio equals zero), the sustainable growth rate is simply given by the return on equity ratio (ROE):

$$\text{Average Sustainable Growth Rate} = \text{Avg ROE}(1 - \text{Avg payout ratio}) = \text{Avg ROE} = \frac{\text{Avg Net Income}}{\text{Avg Equity}} \quad (3)$$

If the conditions that portray the foundational sector at the present hold, it is expectable that the average growth for this sector will decrease and become negative, 0.1%. This results from the fact that 45 (51%) foundations had, in 2014, negative net income.

<sup>46</sup>  $\text{Revenue concentration index} = \sum_{i=1}^N \left( \frac{\text{revenue source}_i}{\text{total revenue}} \right)^2, i = 1, 2, \dots, N$

### Cluster analysis (RQ 7):

The Portuguese foundations can be segmented based on the IPSS and public utility statutes, originating three profiles<sup>47</sup>.

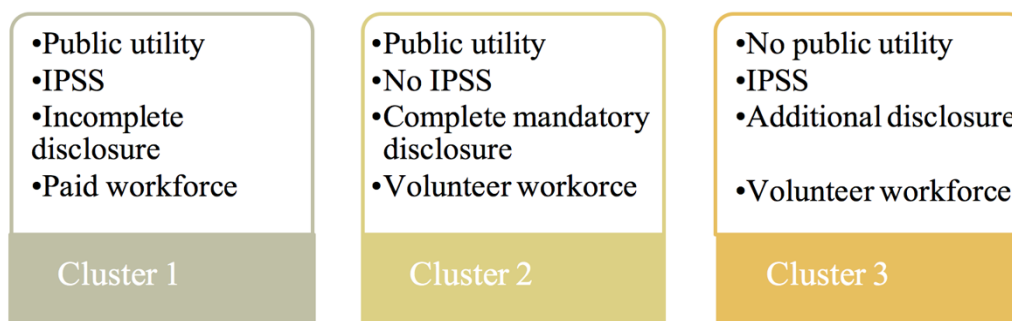


Figure 1. Main characteristics by cluster

Statistical evidence supports the hypothesis that foundations have both public utility and IPSS statutes belong to the same group. Although these foundations benefit from statutes that entitle them to tax exemption, they present incomplete sets of financial statements<sup>48</sup>. *Fundação Champagnat* and *Fundação Pão de Açúcar* are examples of these foundations. Foundations that have public utility status but are not IPSS are grouped in a different cluster. Similarly to foundations in Cluster 1, these foundations are also exempted from income tax (they only pay taxes in the form of autonomous taxation), but contrarily to them, they present complete sets of financial statements as set forth by the legislation. This is the case of foundations as *Fundação Francisco Manuel dos Santos* and *Fundação Caixa Agrícola de Leiria*<sup>49</sup>. On average foundations in Cluster 2 incur in more costs associated to collaborators<sup>50</sup> than the remaining foundations. Finally, none the remaining foundations has public utility status, and only a few (22%) are IPSSs. Accordingly, this is the group of foundations paying more taxes as a percentage of total assets. Additionally to that, they present not only the financial statements deemed as mandatory in the Decree-Law Nr.

<sup>47</sup> The two cluster predictors had an importance higher than 0.8 (in a scale from 0 to 1) in the definition of the different clusters.

<sup>48</sup> Between Clusters 1 and 2 sig=0.032, and between Clusters 1 and 3 sig=0.034.

<sup>49</sup> Even though *Fundação Caixa Agrícola de Leiria* has ties to a corporation there is no statistical evidence of a relation between the taxes paid or any of the two statutes and the existence of such link.

<sup>50</sup> Sig=0.000 and sig=0.034, respectively.

	Cluster 1	Cluster 2	Cluster 3
<b>Clusters' size</b>	30 (34%)	49 (56%)	9 (10%)
<b>Public utility</b>	100%	100%	0%
<b>IPSS</b>	100%	0%	22%
<b>Disclosure</b>	43%	71%	89%
<b>Taxes paid</b> (percentage of total assets)	0%	0.02%	0.14%
<b>Wages</b> (percentage of total assets)	33%	10%	8%
<b>Revenue concentration index</b>	54%	63%	76%

Table 3. Clusters of the Portuguese foundations

36-A/2011, but also an additional voluntary disclosures<sup>51</sup>. Two of the foundations included in this cluster are *Fundação*

*Vodafone* and *Fundação da Faculdade de Ciências da Faculdade de Lisboa*.

Nonetheless, there is no statistical evidence foundations follow a specific pattern of growth according to the cluster they belong to. A unique significant correlation coefficient exists: Cluster 1 tends to have a higher average annual growth rate ( $p=-0.182$ ,  $sig=0.091$ ).

## 7. Conclusion

Recently, foundations in Portugal have been the object of special attention by the government. New regulations have been endorsed, the Decree-Law Nr. 36-A/2011 and LQF. While the former details the financial reporting standards, the later provides the new legal framework for the sector. Comparing the 2009 scenario with the 2012 situation, a clear evolution is observable in the financial reporting of foundational sector in Portugal. Foundations are now presenting more information and in a harmonized manner. Nonetheless, it is recommended that an effort continues to be made to increase the usefulness of the information disclosed.

The literature about financial reporting of Portuguese foundations is scarce, and still limited to the analysis of governance issues and reporting from a preparers' perspective. This Work Project adds to the existing literature a users' view of the foundational sector. This research provides insight into the financial position and performance of foundations in Portugal, unveiling the relation of characteristics specific to foundations and their financial performance.

Portuguese foundations follow different investment patterns according to the public utility status.

<sup>51</sup> Eight (89%) foundations in the third cluster present all the mandatory statements and the statement of change in equity (optional).

Furthermore, the main sources of value creation, subsidies and donations, are influenced by different factors depending on their public or private origin. Although the sector has been growing for the past years, the current sustainable growth rate is considerably lower than the average annual growth rate. Considering this, by cutting on wages, and putting a real focus on volunteer work, net income, that in foundations is totally reinvested in the activities, is expected to increase. Also, although Portuguese foundations have a main CAE (activity code), some of them maintain various secondary CAEs, which can lead to some misunderstandings as to their mission. Foundations could benefit from a clearly defined mission as that has proven influential on donors' decision to give. The analysis also leads to three distinct profiles for Portuguese foundations. The clusters, constructed based on the IPSS and public utility statutes, highlight different patterns for wage costs and income taxes. This analysis identified alarming issues, such as the fact that some foundations with IPSS and public utility statutes that exempt them from taxes are not disclosing the minimal financial statements as required by the law. Hence, it is suggested that tighter control measures apply to ensure legal enforcement and proper use of funds of third parties.

The research has some limitation, however. The review of classification of foundations as IPSS and public utility statutes was still undergoing in 2014, following the endorsement of the Legal Framework for Foundations (*Lei-Quadro das Fundações*). Besides, the Portuguese government has announced further amendments to the existing regulation to be in force in the near future, concerning the concept of financial aid and income. Financial aid will cease to consider payments made by way of compensation or derived from contractual obligations, and funds arising from applications to community funds; while income will include contributions made by founders. Therefore, future research once the final statutes have been published is encouraged. Also, extending the financial statement analysis to a wider time frame, to assess the existence of trends over time and allowing for a better portrait of the foundational sector<sup>52</sup>.

*“Donors don’t give to institutions. They invest in ideas and people in whom they believe.”*  
– G. T. Smith

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<sup>52</sup> The dataset included in section 9 can be used as a starting point.

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