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# **CORE PERSPECTIVES OF PERFORMANCE MEASUREMENT IN NPOS: IN SEARCH OF ACCOUNTABILITY AND LEGITIMACY**

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## **Abstract**

**Purpose:** The Main Purpose of this research is to set the scene for Non-Profit Organizations' performance by synthesizing the vast array of literature on performance measurement frameworks to examine what constitutes performance measurement, and why it is a fundamental issue for the NPO sector. The research also analyses the main issues of performance measurement in NPOs.

**Methodology:** This research takes the form of a literature review. The author draws on extensive research on measuring the performance in NPOs from a diverse range of disciplines to explore definitions, challenges and solutions with performance measurement in NPOs.

**Value:** The categorizations of approaches to measure the performance in NPOs should guide researchers and practitioners.

**Findings:** Non-Profit Organizations need new indicators to assess their economic, social and financial performance, in order to increase the accounting disclosure for social and economic value added resulting from its activities.

**Keywords:** performance measurement, legitimacy, accountability, NPOs.

**JEL:** M00.

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## 1. Introduction

Recently, Non-Profit Organizations have become a positive phenomenon in modern societies, due to its humanitarian role in strengthening social relations between society categories. The relationship between these organizations and the society have developed through three growth stages: in the First Stage, the first generation of these organizations emerged based on the idea of a traditional aid for limited income groups; in the Second Stage the second generation of these organizations emerged - their aim was to strengthen the reliance of these categories on themselves; finally, in the Third Stage, the third generation emerged based on the principle of continuity of charitable and voluntary work and its impact on the state general policy and set charitable developmental models able to influence the social, economic and cultural environment.

Nowadays, Non-Profit Organizations have encountered increased pressures for accountability and legitimacy, from their internal and external stakeholders. The application of a performance measurement framework and system assumes that the managers of NPOs will use performance data and Information to make decisions. Due to the NPOs' rapidly growing influence and reliance on external funding, the interest in how NPOs measure their performance has concentrated and intensified. The scientific literature is dominated by quantitative research into performance measurement of for-profit organizations (FPOs) (Cordery and Sinclair, 2013), hence there is a need for conceptual research on the implementation of NPOs' performance measurement. The qualitative accounting research seeks to stimulate debate based on this type of research into the use of performance measurement frameworks both within NPOs and between NPOs and their external stakeholders.

The main purpose of this research is to set the scene for Non-Profit Organizations' performance by synthesizing the vast array of literature on performance measurement framework to examine what constitutes performance measurement, and why it is a fundamental issue for the NPOs sector. The research also analyses the main issues of performance measurement in NPOs.

## **2. Background**

### **2.1. Performance Measurement in Non-Profit Organizations**

#### **2.1.1. Performance Measurement, Definitions and Opportunities**

Since the inception of Accounting, the traditional view of the accounting function has been considered as an activity directed for a specific purpose, which meet stakeholders' needs of financial information. However, today accounting has another important function in addition to its financial reporting function, viz. to support the financial performance measuring (Trussel and Parsons, 2008). Recently, calls for greater accountability have become widespread, so over the past 25 years, the issue of measuring the performance in NPOs sector has gained increasing relevance among researchers (Arena et. al, 2015) and NPOs are required to prove their social efficiency and effectiveness, while from an academic perspective, there has been an explosion in tools and methodologies for measuring the social performance and impact of NPOs in particular.

Therefore, considering the growing size and influence of the NPOs and their dependence on external sources of funding, it became necessary for NPOs to prove their responsibility and accountability through performance indicators and ratios. Considering the growing competition for funding sources, NPOs are under increasing pressure to demonstrate performance excellence in order to raise operating funds (Lee and Nowell, 2015).

In academic spheres, performance can be defined as “intentional action” and therefore measuring the performance is an evaluation of the results from it. Performance measurement for the for-profit organizations focus on creation value that is, intentionally money creation for shareholders, and this relationship does not exist in NPOs, where the resource providers are donors (sponsors) who do not have a vested interest, even when they own some equity. The limitation to distributing profit means that the resource providers can't share in any monetary value created. While members may receive value commensurate with their subscriptions to membership organisations, it is likely that they will also contribute volunteer effort to the public good of the club and therefore create value for others to enjoy. In other NPOs, the resource providers (for instance, donors or philanthropic funders) also don't receive benefits commensurate with the value of their donations. Instead, the NPO's products and services are provided to third parties (Cordery and Sinclair, 2013).

As monetary value creation for shareholders is not a relevant measure for NPOs, these organisations are encouraged to measure performance in pursuit of their social mission. Performance measurement serves two main

purposes for NPOs: (1) to prove its worth (to donors) and, through reporting internally, (2) to improve organizational performance by learning from assessment of its activities and from comparison to others (Huang and Hooper, 2011/ Saj, 2013).

Simplifying a little, accounting measures are basis for performance reporting. A study on philanthropic funders (Huang and Hooper, 2011) shows that financial information was of limited use in choosing which NPOs to fund. Donors noted that non-financial information is more important; in particular, NPOs reports on how they have delivered on their mission or activities, and the society benefits provided. (Huang and Hooper, 2011) note that funders were also interested in what a NPOs has learned from undertaking a particular project. This shows that learning is important for external providers as well as for improving organizational practice. (Cordery and Sinclair, 2013).

### **2.1.2. Historical View**

(Farbes, 1998) study considered the beginning of interest in accounting thought in this area, which addressed the historical development of performance measurement in non-profit organizations during 1977-1997, recently, the academic literature is dominated by quantitative studies and conceptual papers into performance measurement and management in NPOs.

Overall, accounting research in the past ten years has neglected performance measurement in the non-profit sector due to the greater interest in the private sector. Moreover, the study of (khieng, 2014) showed lack of interest in accounting thought in developing countries, which ensured by (Carnochan et. al, 2014) study that referred that performance measurement practices are superficiality and lack of effectiveness.

### **2.1.3. Performance Measurement Motivation**

From a stakeholder perspective (Epstein and McFarlan, 2011) study indicated that the main motive to measure the performance, especially efficiency is to ensure the continued funds flow through the organization's ability to demonstrate its ability to achieve objectives in financial ratios, while (Alnoor, 2003) emphasized that the non-profit organizations responsible for achieving legitimacy by showing its ability to achieve its objectives and measuring its achievements, and must ask itself "are we really delivering on our mission not just meeting budget and are we getting maximum impact from our expenditures?" On the other hand, (Alnoor, 2003) study confirmed that one of the reasons for the non-performance assessment in this sector is the organization's culture which tend to gain legitimacy due to the activities and do not consume time and cost in performance evaluating especially with the cost associated with it. But there will be difficulty in the comparison

between non-profit organizations with the different funding size, especially when donors tend to use metrics and performance indicators in the decisions of donations, and the small-sized organizations will be more affected.

## **2.2. Performance Measurement: Challenges, drawbacks and solutions**

### **2.2.1. Challenges and drawbacks**

Based on the above, academic research attempted to examine the current financial performance measurement environment in non-profit organizations (Cordery and Sinclair, 2013/ Epstein and McFarlan, 2011/ Kirk and Nolan, 2010/ Lee and Nowell, 2015) and referred to many challenges facing the performance measurement such as:

- The lack of current appropriate financial and non-financial performance measurements. In light of the current traditional indicators are inadequate to measure and evaluate performance (Tinkelman and Donabedian, 2007) and (Andreaus and Costa, 2014) study Confirmed that the reasons for the inadequacy of the current financial performance indicators for non-profit organizations is the focus on short-term perspective. While (Tinkelman and Donabedian, 2007) noted that the inadequacy of the current financial indicators due to its dependence on the perspective of profitability and maximize the wealth of shareholders (owners)

- Non-profit organizations facing difficulties to demonstrate an impact from their services since the intended effects may not be apparent for several years, and many studies agreed that the reason many non-profit organizations didn't report their performance is the difficulty in measuring it. (Cordery and Sinclair, 2013/ Eckerd, 2015)

- The absence of traditional equity concept and thus the absence of natural controlling mechanisms of owners or shareholders.

- (Cordery and Sinclair, 2013) study refereed that the most important obstacles to measure and evaluate the performance is the cost associated with this process.

- Efficiency is the relationship between the output and input (Tinkelman and Donabedian, 2007) but measuring the output value is considered the main obstacle to measure the efficiency of non-profit organizations where the majority of them have no reciprocal market, and despite the emergence of this problem with the inception of this sector, but the accounting thought so far cannot find solutions.

- The consequent of non-profit target and public services, non-profit organization's activities considered collective consumption from the economic point of view from hand, and from another hand and due to non-profit target

accounting function must provide other appropriate ratios other than profit to evaluate and measure the organization performance.

### **2.2.2. Solutions**

On the other hand, many studies provided proposed solutions to performance measurement problems, such as:

- Restructuring accounting standards and financial statements, consider one of the most important elements for creating social responsibility accounting standard.

- Using of balance score card (BSC) consider the ideal model to evaluate the performance in services entities. (Cordert and Sinclair, 2013 / Lee and Nowell, 2015/ Arena et. al, 2015)

- Kirk and Nolan (2010), Carnochan et. al. (2014) and Arya and Mittendorf (2015) showed the importance of measuring the performance from stakeholders perspective and focus on effectiveness more than traditional indicators.

- Kirk and Nolan (2010) study proposed the inclusion of a separate descriptive statement in the financial report about the organization achievements (mission statement) as an alternative to profit when assessing the performance growth of an organization. This proposal is supported by (Saj, 2013) study about the need to include performance statement within the annual financial report, while (Trussel and Parsons, 2008) confirmed before these proposals that performance assessment must be made from the donors' point of view, because they are the most important category of stakeholders on the financial and operational sustainability of non-profit organizations. This confirms the researchers' belief that non-financial indicators are more meaningful and objective than the financial indicators in measuring the performance of non-profit organizations considering the specific nature of these organizations.

The study of (Tinkelman and Donabedian, 2007) suggested that financial ratios are deemed important by stakeholders and given priority by NPO managers not because they provide an adequate and complete measurement of the organizational performance but because they are readily available (though partial) measures and because no thorough measures have so far been developed. The existing literature on NPOs does not contain adequate measurement techniques to assess the value of their output. So the first objection is that accounting ratios are incomplete performance measures that fail to include any consideration of the quantity, quality, and value of outputs and ignore the organization's strategy. Additionally, (Meyer et. al, 2013) study called for the need to include a set of financial ratios and indicators in the financial report to measure the organization's performance.

Academic studies have sparked a debate on methods to assess the social performance of these organizations and the degree of effectiveness of their role in society, in another side (Aggarwal et. Al, 2012) observed that there is a relationship between the board of directors and financial performance, where it concluded that the board of directors positively associated with the number of programs pursued by the NPO. Despite the shortcomings of economic efficiency approaches to measurement, TSOs continue to experience pressure to report in quantitative forms. However, in practice it can be difficult to develop effective and consistent benchmarks for measuring such performance due to the special nature of these organizations.

However, the need remains for NPOs to show the difference they make in their communities (added aalue), to be clear about the outcomes they are working towards, and to use performance frameworks to utilize scarce resources effectively. Where the reason many NPOs did not report their performance measurements was the difficulty in measuring them. So Performance is an important issue in NPOs because they are not only established solely to generate profits, but is also established with specific social missions and objectives to fulfil the needs of society, as the accounting literature referred, it's difficult to find and create ratios to measure the performance of non-profit organizations due to the special nature of the activity and its adoption to long-term measure performance policy. Yet, there are challenges and drawbacks to measuring performance, Hence there is a need for empirical studies on the implementation of NPOs' performance measurement, management and reporting (Cordery and Sinclair, 2013/ Carnochan et. al, 2014) due to the weakness of the current system associated. (Epstein and McFarlan, 2011).

Besides, the study of (Lee and Nowell, 2015) concluded that academic studies address the assessment of non-profit organizations' performance from two different points of view in an attempt to develop an integrated framework for measuring and assessing performance - as a tool that can be used by the NPO managers to improve their working environment and as a tool to strengthen and enhance the relationship between the organization and its stakeholders.

(Eckerd, 2015) considered efficiency and effectiveness as determinants for attracting funds to non-profit organizations, which places additional burden on the accounting regulation. Therefore, it can argued that he inclusion of a report about the performance measurement in the financial statements of non-profit organizations is not a whim but a necessity. Moreover, (Andreaus and Costa, 2014) argued that accountability is perceived in different ways according to the economic sector but in the non-profit sector assessing the performance and accountability from the financial and economic

point of view only is not sufficient and does not reflect the sector activities. So far, there is no specific framework for accountability in non-profit organizations, and in case of using the financial assessment only, it will be misleading. But with non-profit aim a major question appeared in the academic research: What are the limits of efficiency and effectiveness in non-profit organizations in the absence of profit? How can the accounting function answer this question? From the above, the researcher agrees with (Arya and Mittendorf, 2015) that “the way we think about NPOs is dead wrong”.

### **3. Performance Measurement Development, Special Issues**

#### **3.1. Non-Profit Organizations and Legitimacy**

Normand and Wootton (2010) and Meyer et. al. (2013) studies showed that non-profit organizations historically used the outputs of the accounting function from financial reports to gain legitimacy for their activities and existence. In the case of NPOs, this legitimacy is critical since they often depend upon external contributions to continue. Over the past decade, concerns have been raised about the legitimacy and accountability of NPOs, particularly on the adequacy of financial reporting and auditing mechanism. In United State of America for example, these concerns have escalated as more financial scandals became more apparent, (Neely, 2011) and similarly several charities in United Kingdom involved in fraudulent activities.

Although the most of academic studies in late last century referred to that donor rely on information from financial reports for assurance that donations are used appropriately. But until now, the role of financial reporting in the governance of NPOs is less clear, and its objectives are not easily translated into financial terms, non-profit organizations currently provide information in the financial statements that differ in their form and content from the reality of their transactions. More recently, several studies have explored further the annual statements as a key source of information on the activities of non-profit organizations and a key means of communication between the organization and its stakeholders (O'Brien and Tooley, 2013) .

Therefore, NPOs are seen be legitimated, to enjoy legitimacy, if there exists a generalized perception or assumption that their actions are desirable, proper, or appropriate within a socially constructed system of norms, values, beliefs, and definitions.

Legitimacy provides a roof that will protect the organization from crises or from the effects of unfavourable actions. Nonetheless, it is mainly based on the congruence between the past actions of the entity to be legitimated and the shared values of some social group. Thus, legitimacy is



bestowed by a collective audience and not by individual observers. (Meyer et.al, 2013).

### **3.2. Non-Profit Organizations and Donations**

Accordingly, numerous studies addressed the current role of financial statements in this sector and the possibilities for their enhancement. However, most empirical research emphasized the importance of financial reporting in non-profit organizations not only to monitor performance in terms of their efficiency and effectiveness in using public resources, but also to provide information to all stakeholders from legislators, donors and government authorities about their economic resource. This was confirmed in a study conducted by (Andreas and Costa, 2014), which proves that financial reports have a great impact on donors and other stakeholders in decisions making (Behna et. al, 2010). Where (Harris et. Al, 2015) study provided a field evidences linked between fund decisions from donors and the financial reports' quality, and its ability to show the achievements of the organization's activities (performance).

### **3.3. Non-Profit Organizations and Accountability**

Non-profit organizations worldwide are confronted with an increasing demand for accountability and improving financial transparency (Kellner et.al, 2017) and (Meyer et. al, 2013) study has summarized the concept of accountability in non-profit sector with "meeting stakeholders needs".

In general, financial reporting is related to financial accountability, and in considering accountability (Connolly and Hyndman, 2013) referred to two questions: to whom is a NPO accountable; and what form should that account take? Since there is a range of stakeholders who can be served by the financial reports, the annual financial statement should enable the stakeholder: to understand the NPO's structure and performance, that is, its activities and achievements; and gain a full and proper appreciation of the NPO's financial transactions, which agreed with (Ball et. al, 2012) study about the economic and social role of financial reporting and its role in influencing accounting standard-setting. This view is supported by (kirk and Nolan, 2010) study with the importance of clarifying the relationship between the financial statements and the organization vision and strategy. A similar research by (Jones and Mucha, 2014) studied the links between financial reporting and the organization size, administrative structure and geographical range.

During the last four decades, many studies addressed the importance of high-quality accounting and reporting in non-profit sector (Bird and Jones, 1981). A key result was that poor accounting and reporting (and, as a consequence, the possibility of scandals) could severely undermine confi-

dence in the sector and reduce both charitable giving and activity and the remaining gap between stakeholders information needs and the information disclosed in annual reports (Connolly and Hyndman, 2013,) and (Thornton and Belski, 2010) noted that the lack of financial report quality among non-profit sector has several cases, such as, many NPOs don't have sufficient internal control systems to track functional expenses accurately, consequently donors and other stakeholders are unable to construct a reliable picture of the NPOs activities.

#### 4. Core Perspectives of Performance Measurement in NPOs

The researchers relied mainly on (Epstein and McFarlan, 2011/ Cordery and Sinclair, 2013/ Morgan, 2013/ Lee and Nowell, 2015/ Kellner et.al, 2017/ Dan and Crişan, 2018) to develop this part (Table 1).

Table 1

*Core Perspectives of Performance Measurement in NPOs*

Performance Dimension	Main Focuses	Performance Measures or Criteria
<b>Inputs:</b>	The ability of NPO to acquire resources (financial and nonfinancial)	<ol style="list-style-type: none"> <li>1. Revenue growth</li> <li>2. Revenue diversification</li> <li>3. Revenue concentration</li> <li>4. Governmental funding</li> <li>5. Acquire and manage human resources</li> <li>6. Strength of the relationship with donors</li> </ol>
<b>Organizational capacity</b>	Consists of human and structural features that facilitate NPO's ability to offer products and services	<ol style="list-style-type: none"> <li>1. Capacity to innovate</li> <li>2. Employee satisfaction</li> <li>3. Information system capabilities</li> </ol>
<b>Outputs:</b>	Entails a specification of the scale, scope and quality of products and services provided by the organization focuses on organizational targets an activity that has direct linkages to organizational mission accomplishment	<ol style="list-style-type: none"> <li>1. Added-value</li> <li>2. Number of participants served</li> <li>3. Quality of services provided</li> <li>4. Social Contribution</li> <li>5. Hours of services</li> <li>6. On-time service deliveries</li> </ol>

<b>Performance Dimension</b>	<b>Main Focuses</b>	<b>Performance Measures or Criteria</b>
<b>Outcomes:</b>	The impact of (activities / outputs) on the beneficiaries Extent to which the organization satisfied and met the needs of the population the non-profit organizations are intended to serve	<ol style="list-style-type: none"> <li>1. Beneficiaries' growth rate.</li> <li>2. Activities provided growth rate.</li> <li>3. The gap between the current and expected service beneficiaries (external effectiveness)</li> <li>4. Correlation the results achieved with the expected (internal effectiveness)</li> <li>5. Quality of life, well-being</li> <li>6. Citizen engagement and democratization</li> <li>7. Quality of life and well-being.</li> </ol>
<b>Impact:</b>	Long-term benefits (Direct / indirect) achieved to the society	<ol style="list-style-type: none"> <li>1. Impact indicators, according to the activities of each organization</li> <li>2. In the case of the education-oriented organizations may be the illiteracy rate in the society before and after,</li> <li>3. And in the field of health care the average age in the community, etc.</li> </ol>
<b>Legitimacy</b>	Reputation / Focuses on a positive relationship with other organizations, reputational legitimacy within the community and field, compliance with laws, and best practices	<ol style="list-style-type: none"> <li>1. Surplus / deficit during the financial periods</li> <li>2. Revenue growth rate</li> <li>3. The growth rate of donors</li> <li>4. Stakeholder satisfaction</li> <li>5. Coherence of activities with the stated mission</li> <li>6. Image of the organization on the mass media</li> </ol>
<b>Administrative Efficiency</b>	<ol style="list-style-type: none"> <li>1. Admin. expenses divided by total expenses</li> <li>2. Percentage of revenues organization spends on admin. expenses</li> </ol>	
<b>Programme efficiency</b>	<ol style="list-style-type: none"> <li>1. Percentage of total expenses spent for its mission</li> <li>2. Program expenses divided by total expenses</li> <li>3. Program expenses growth</li> <li>4. Productivity rate (outputs divided by inputs)</li> <li>5. Current spending factor.</li> </ol>	

## 5. Conclusion

Performance measurement has gained increased importance for non-profit organizations, and the current accounting literature is populated with several performance measurement frameworks. In this paper, the researcher seeks to accomplish two goals. First, to review the literature on non-profit

performance measurement; an second, to develop an integrated framework to identify directions for advancing the study of performance measurement.

This literature review has dichotomised performance measurement into methods and actions required to discharge legitimacy and accountability, and those undertaken to improve practice within a NPOs. While research into accountability in NPOs has expanded in both accounting and Management spheres nowadays, but internal performance measurement has been largely left to the evaluation discipline. (Cordery and Sinclair, 2013)

Finally, it became clear to the researcher that non-profit organizations have become in light of the recent advances of the activity of these organizations need to use some new indicators to assess economic, social and financial performance, in order to increase the accounting disclosure for social and economic value added by the activities of these organizations, which contributes to develop the comprehensive accounting function.

## 6. Acknowledgements

The authors would like to thank Prof. Mostafa Albaz (Professor of Financial Accounting - Suez Canal University - Egypt) for his helpful comments and suggestions, the errors and omissions remain the sole responsibility of the author.

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ISSN 0323-9004

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Svishtov, Year LXXII, Issue 3 - 2019

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