

Qualitative Risk Assessment of Financial Resources of NGOs

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Abstract

Non-governmental non-profit organisations have an important place in the society of the 21st century in the Czech Republic. These organisations involve civic associations, public benefit organisations, foundations and endowment funds, the Churches and religious societies in the Czech Republic. The aim of this paper is to find out various types of NGOs risks and recommend their management. The methodology is based on risk measurement in profit organisation assets. Weaknesses and threats were listed there for each financial source using a SWOT analysis. Risk of financial sources in NGOs is important to be controlled from the point of view of its long-term future financial stability. This paper deals only with qualitative risk assessment and gives recommendations to control risk mostly focusing on strict control, good information and professionalism in NGOs.

Keywords: risk analysis, weakness, threats, non-profit non-governmental organisation

Introduction

Nongovernmental non-profit organisations (NGOs) have an important place in the society of the 21st century. A partial definition of the non-profit organisations can be found in Act No. 586/1992 Coll. income tax. These organisations are legal entities, which are not established for profit.

There are four different forms of NGOs in the Czech Republic. The forms of civic associations are established pursuant to Act No. 83/1990 Coll., on the Association of Citizens, as amended; are mainly sport, ecologic, hobby or other kind of organisations. The second form – Public benefit organisations (p. b. o.) are founded in the Czech Republic and since year 1996 according to the Act No. 248/1995 Coll., of public benefit organisations. Their aims are in welfare services of various areas from culture through health and social services to ecology. The third form – Foundations and endowment funds are

purpose-built associations established pursuant to the Act No. 227/1997 Coll., of foundations and endowment funds. The fourth form – Churches and religious societies are established pursuant to Act No. 3/2002 Coll., on churches and religious societies.

NGOs are not only free-time groups, but also organisations which together with the state subsidized non-profit organisation provide social, health, and other services that are very often necessary to people. NGOs should be organisations financially secured by private sources and not fully dependent on state subsidies and grants. There are some risks for each financial source and the NGO has to control them because in case that the NGO loses important part of main source, it could not continue its activities. Each financial resource, that is not guaranteed, is associated with a certain amount of risk, even the ones funded from the state budget (operating subsidies), and could be cut in connection with low financial support currently enforced by politics.

The aim of this paper is to identify various risks of NGOs' financial sources and finding out possibilities to control them.

Materials and Methods

Based on the methodology for determining the risk of assets we transform it to the methodology of risk analysis for sources of financing NGOs. For qualitative risk assessment we used the first step described within the strategic risk management process according Wilson-Grau (2003), which has five steps. The first one: to identify the principal positive risks (or "opportunities") and the major negative risks (or threats or dangers) to achieve the purpose of the organisation or one of its work units.

The risk analysis according Smejkal and Rais (2006, p. 81) usually involves:

1. identification of assets – the definition and description of the organisation assessed the assets they own,
2. determining the value of assets – the value of assets and their importance for subjects, assessment of potential impact of their loss, damage or changes to the existence or behaviour of the entity,
3. identification of threats and weaknesses – identifying types of events and actions that may adversely affect the value of assets, identification of vulnerabilities body, which may allow exposure of threats,
4. determining the seriousness of threats and vulnerabilities level – determining the likelihood of threats and vulnerabilities level of subject to the threat.

The risk level is determined by the value of assets, vulnerability and asset levels of threat. Quantitative assessment is not aim of this paper.

The risk analysis of financial resources is in this paper limited to the qualitative assessment by identifying threats and weaknesses resulting from the SWOT analysis of various sources of funding and as well as some opportunities because of the theory of the strategic risk management process. There are some strategies of potential risk treatment. We used ones defined by Severa (2004, p. 22). For each risk we could recommend various strategies to handle it based on different tactics and provided by the following actions:

- Strategy “avoid” the risk – the banning of some risk processes and activities;
- Strategy “sustaining” of current rate of risk – acceptance of risk on the actual level without any other activities;
- Strategy “reduction” of risk – decreasing probability of unwanted occurrence;
- Strategy “transfer” the risk – decreasing impact of risk e.g. by insurance;
- Strategy “use” of risk – possible use of differences in market values for immediate buying of commodities targeted to sell them on another market (arbitrage).

Defining the various financing sources

Financial sources are defined according to the donator, by their similar characteristics, such as the timing, using restrictions, requirements for the acquisition, in seven groups.

The European Union funds (EU funds)

The use of EU funds is strictly tied to the budget and specification in the project. The possibility of multi-annual or annual projects is related to the proper bureaucratic agendas, which often require co-financing or pre-financing.

Public and state resources

Financial sources are distributed under the budget rules of authorized municipalities, county, or ministries; very often operating subsidies – some NGOs especially providing social care are fully depended on them. These are some resources from public budgets embedded in legislation, which may include the legal rights of Churches (Act No. 218/1949 Coll., On Economic Security State Church, as amended), or sports organisations (Act No. 115/2001 Coll., On Sports’ Support).

Individual donors

These are donations of individuals, very often collected by directly approaching people within public (charity) collections. Secondary motivation, besides willingness to support NGO, could be the possibility of reducing tax liability by the value of donation. The right to tax advantage arises, when the purpose is in accordance with Act No. 586/1992 Coll. on income tax.

There was an important group of donors in the USA, who donated annually 10% from their earnings. It is almost a social standard. It is true that times are changing and this social standard becomes weaker. In average the Americans donate 1.5 – 2% of their profit (Šedivý 2009). According to the data from General Financial Directorate private donations in the Czech Republic (individual donators and firms together) reached 3.8 million CZK and annually increased by 5.4% and after three years the amount is on the same level as before the crisis, which influences it (Chrástová 2012).

Gifts and sponsorship of legal entities Legal entities are companies, joint-stock or Ltd., or other profitable organisations. The entity can reduce its tax by the value of a gift base similarly to that of individuals. Sponsorship or sponsorship contribution is provided under a contract for advertising and sponsorship contracts.

Foundations and endowment funds

Foundations and endowment funds are purpose property associations established pursuant to the Act No. 227/1997 Coll. On Foundations and Endowment Funds and amendments of some related acts. They are established for achieving community goals. Contributions are distributed as grants to other NGOs, but also to individuals or other non-profit organisations, hospitals, schools, etc. The amount of distributed contributions depends on fundraising activity targeted to work with individuals. It depends on evaluation of its assets, and success in their possible business activity in the future. According the New Civil code foundations and endowment funds will have more possibilities in business activities (Deverová 2012).

Volunteers

Volunteering creates a significant economic contribution to the society. Quantifying the value of volunteer work can be done by quantifying the working time of volunteers. Calculating this working time can be done using three methods according to Musilová (2005).

If volunteers are working for NGOs, they “donate” their time instead of physical or financial resources. This resource is crucial to the functioning and survival of some NGOs that are dependent on some degree of volunteer work.

Self-financing

These are revenues from activities, called “self-financing”. It is a membership fee at the civic associations and religious societies. Other income may be income from the rent of movable and immovable assets, income from the foundation equity, income from investments, from the owned joint-stock company. The self-financing can also include sales of goods and services. Assessment of such risks is likely to be similar to the risk assessment of assets. The paper does not deal with this financial source and its risk.

Results

Identification is based on the SWOT analysis and analyses of the external and internal environment, which has, or may have, a financial impact on resources in terms of potential threats and weaknesses representing risk possibility.

NGOs could manage risk, which is dependent on weaknesses. Threats are caused by external environment and its control is limited for NGOs. Tab. 1 summarizes risks and possible tactics to control them. Implementation of strategy “use” of risk would be very difficult for NGOs and we could not find any example, of how to do it. Using strategy “transfer” the risk is possible to implement generally for planning financial sources for the NGO. If there is some demanded source with the uncertainty of getting it, the NGO could insure it by another one. Next, free strategies for controlling the risks, we recommend for using them as follows (Tab. 1).

Risks of project financing

The risks related to the project financing are very often specified by budget and time limitation of a project. Project financing is typical for the *EU funds*, *Public and state resources* and *Foundations and endowment funds*. Financing by these sources does not have to be important for the regular activities of NGOs. E.g. EU funds support projects which are aimed at helping and developing NGOs for their future sustainability. Risk of such a kind of source does not affect directly running of NGOs. If NGOs want to control these risks, they could implement the strategy “reduction” of risk by a high-quality processed project, budget and its strict inner control, financial control according to the project, good informing and professionalism of employees.

The NGO could not directly influence threats. In case of the problem with banks ignoring NGOs, it is possible to take an interest-free credit within the program “3P” of two foundations and one bank called 3P (NROS and ČSOB, a.s.) to bridge the period to obtain the money from the EU funds. The NGO could use strategy “avoid” and try to run without any dependency on this kind of financing its activities.

Risks of operating subsidies from public and state sources

Different risks are related to the operating subsidies or financial sources provided by laws. Many NGOs are dependent on them. The NGO could indirectly reduce the risk by decreasing their ratio in the portfolio of financial sources, using strategy “avoid” or “reduction” and try to run without majority dependency on this kind of financing. Implementation of strategy “sustaining” current level of risk may result in a higher future vulnerability in case of lower state support.

Table 1: Risks of financial sources, their possibility of control and tactics

Resource	Risks (weaknesses/threats)	Control	Tactics
The EU funds	<ul style="list-style-type: none"> – Limitations of use of resources within the project – Breach of contract needs returning funds – Sustainability of the project after funding ends – Bureaucratic demands 	Partially Yes Yes Yes	Reduce
	<ul style="list-style-type: none"> – Problem with banks ignoring NGOs – Limitation of the EU budget period – Corruption scandals – stopping the flow of subsidies to the CR 	No No No	Avoid
Public and state	<ul style="list-style-type: none"> – Limitations of use of resources within the project – Areas of support 	Partially No	Reduce Avoid
	<ul style="list-style-type: none"> – The fiscal deterioration – The influence of state social policy – General Czech economic situation 	No No No	Avoid/ Sustaining
Individual donors	<ul style="list-style-type: none"> – Finance demanded for fundraising of individuals – Unprofessional staff of the NGO – Inability of the NGO to address and convince individual donors – Unpopularity of services of the NGO – Image of the NGO 	Yes Yes Yes Partially Yes	Reduce
	<ul style="list-style-type: none"> – Bad living conditions of people – Willingness to donate – Willingness to donate regularly – Other NGOs competition – Lack of state motivational tools 	No Yes Yes Partially No	Sustaining Reduce Reduce Reduce Sustaining
Companies	<ul style="list-style-type: none"> – Discrepancy between the mission of the NGO and the field of business of the company 	No	Avoid
	<ul style="list-style-type: none"> – The economic situation of the profit organisation – Economic environment (recession) – The importance of CSR – Lack of state motivational tools – The decision of the shareholders – Reducing marketing costs will lead to a reduction in sponsorship 	No No Partially No Yes No	Sustaining Sustaining Reduce Sustaining Reduce Sustaining
Foundations and endowment funds	<ul style="list-style-type: none"> – Low annual contributions – Limitations of use of resources within the project 	No Partially	Sustaining Reduce
	<ul style="list-style-type: none"> – Situation in financial markets—to evaluate the influence of the foundation equity investments – Foundations of corporate funds depend on the prosperity of the company – Effect of business activity to the donators 	No No No	Avoid/ Sustaining
Volunteers	<ul style="list-style-type: none"> – Intensity of services provided by volunteers – Attractiveness of services – Unwillingness to work for free 	Yes Yes Yes	Reduce
	<ul style="list-style-type: none"> – Lack of suitable candidates – Injury to the NGO reputation – Own selfish interests 	Yes Yes Partially	Reduce

Source: Processed according methodology

Risks of individual donors

In the case of individual donors the NGO could implement the strategy “reduction” of risk by preventing it. Professional attitude and usage of various kinds of fundraising methods could prevent the risk, e. g. asking broader range of people and active work with them.

There are some less popular kinds of activities, which are less supported by individuals. People easily support human help, social care, children, then animals, ecology, or drugs. The NGO can change humans’ view by better informing them about their activities. If the NGO takes care of its donors, they will become regular donors and support the NGO for many years. Their gifts are a stabilizing part of the NGO’s financial portfolio, e.g. Greenpeace works giving gifts to individuals.

Risk of gifts and sponsorship of legal entities

Gifts and sponsorship of companies could be a suitable part of NGO’s financial portfolio. Because of dependency on the economic situation this source has a high level of risk. The NGO cannot influence this fact. Further, there can be a discrepancy between the mission of the NGO and the business field of the company. In this case the NGO could significantly damage its image and loses other donors. The NGO could use the strategy “avoid” and try to run without any dependency on this kind of financing of its activities.

In case of risks, coming from threats, the NGO can use the strategy “sustaining” current level of risk or “reduction” it by giving more information to the companies.

Risks in case of volunteers

If NGOs want to control risks of this source, they could implement strategy “reduction” by good training of volunteers, informing and professionalism of employees, who work with them, including a get-together as a ceremony of gratitude. It is possible to prevent possible image damage by a non-disclosure agreement of volunteers and by documenting their record of education, legal integrity or criminal record.

Discussion and Conclusion

Due to qualitative analysis, tens of risks were determined within the financing sources of NGOs, except risks of sources from own NGOs activities, which was not the subject of this paper. Part of the methodology assessment of assets risks was used for assessment of NGOs’ risks by finding threats and weaknesses of the particular financial source. For risks we recommend several possibilities of tactics, how to manage or control them.

Determining the value of financial resources for the organisation is based primarily on the needs of the organisation. The severity of threats and weaknesses depend on the organisation’s portfolio of financial resources and also on

the type of organisation in terms of salary or personal expenses. The loss of short-term sources, e.g. grants, which often does not cover necessary labour costs, may not cause serious risk. In this case the NGO can implement the strategy “sustaining” current level of risk.

In case of dependency of the NGO on operating subsidies from public budget, the NGO can use the strategy “avoid” or “reducing” and try to run without this source or with its lower amount and try to find another one.

In case of economic recession, organisations largely depending on revenues influenced by market risk, can be relatively unstable. If the organisation depends on the foundation or endowment funds, which are dependent on the source affected by market risk, then in case of economic recession, NGOs must find an alternative source to ensure operation.

Risks related to the gifts of individuals or volunteers are possible to control by using the strategy “reducing”. NGOs can reduce it by better professional working with donators and volunteers. In the case of individuals the NGO should use various fundraising methods and take a good care of them. These sources seem to be stabilisation part of NGOs’ financial portfolio because their risks are possible to be controlled or partly controlled. Their rate of possible control can be a topic for further studies using the quantitative analysis.

NGOs should use the strategy “transfer” the risk in every case, when they use financial source with risks, which are not possible to control. They should insure this kind of source by another one or ones, which are partly controllable. More differentiated portfolio of financial sources will be stabilising unit too. This could lead to the long-term stability and sustainability of NGOs.

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Kvalitativní hodnocení rizik finančních zdrojů nestátních neziskových organizací

Nevládní neziskové organizace mají v České republice důležité místo v tržní společnosti 21. století. Těmito organizacemi jsou občanská sdružení, obecně prospěšné společnosti, nadace a nadační fondy, církevní a náboženské společnosti. Cílem příspěvku je najít rizika pro různé skupiny finančních zdrojů neziskových organizací a navrhnout jejich zvládnání. Tyto zdroje jsou odlišeny na základě podobných vlastností. Metodika vychází z metodiky pro analýzu aktiv u ziskových organizací. Výčet slabých stránek a ohrožení vychází ze SWOT analýzy. Riziko finančních zdrojů v NNO je důležité z hlediska trvalé udržitelnosti a stability organizace v budoucnosti. Velké části rizik je možné se vyhnout profesionalizací organizace, informovaností a vnitřní důslednou kontrolou.

Klíčová slova: analýza rizika, slabé stránky, ohrožení, nestátní nezisková organizace

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