

AN ACCOUNTING INSIGHT ON ROMANIAN SOCIAL ECONOMY ENTITIES SUSTAINABILITY

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Abstract: Social economy has a core importance in creating jobs and delivering goods and services for the disadvantages groups members. Even if no searching for profit, the Social Economy Entities (SEEs) have to maintain a financial stability allowing the continuously fulfilling their social mission. Sustainability is crucial in delivering to the disadvantaged. Romania financed during the years 2020 and 2021 around 2800 SEEs, but not very much is widely presented about their activity. Financial information is still publicly available, so the SEEs economic behaviour may be monitor and even predicted as a trend, using forensic accounting techniques: reviewing the existing public information on public and private sites, analysing the summary of financial statements, as it may be found on the Ministry of Finance online database, and interpreting the evidence so gathered. Within this paper, the sustainability of a sample consisting on 172 SEEs incorporated in Maramureş County, Romania is analysed using publicly available data, including by the use of the indicator of financial distress (Z- Altman score). It reveals that in actual conditions, about 80% of the sample population are in high risk of bankruptcy, only 6% of them being financial sustainable. This research may be useful for national deciders and local social economy facilitators in focusing the aid and support actions, and also for the SEEs initiators, in preparing the best ways of managing the assumed risks.

Keywords: forensic accounting, social economy, efficiency, sustainability.

JEL Classification: A13, B55, L31, M14.

1. Background of SEEs in Romania

Raised at the intersection of economic and social policies, the social economy aims to bust the social cohesion, by including disadvantaged people labour into public services, affordably delivered to the ones they needed the most. The prevalence of social values and mission over profit making activities separates the social economy entities from the profit-oriented organisations. SEE should use internal and external financing resources in delivering social activities, in the benefit of marginalized groups or persons, into the market failure area. Performance of these entities is seldom reported to financial indicators, but to social activities, results and impact. Even so, for an activity to be deployed, financing is needed, so financial aspects are not to be neglected by interested parties in considering different performance approaches of SEE's.

Worldwide known as "The third sector" (Levitt, 1973), the contemporary social economy system is regulated in Romania since 2015, imposing four conditions for the SEE recognition: to act in general interest, to reinvest in social activities at least 90% of the annual gross profit, to transfer its assets to other social enterprises in case of business liquidation, and to employ people at a considered fairly wages discrepancy, which is no more than eight times between the smallest and the bigger salary. As a right corresponding to these obligations, the SEE's might receive state subsidies for capital and work, specially

form EU funding through European Social Fund (ESF). SEE's may also receive some national subsidies if employing disadvantaged people.

The National Employment Agency (NEA) is monitoring the recurrent activities of SEE's, since the Managing Authority (MA) for Programs financed by the ESF is monitoring for a relatively short period the way the ESF subsidies are spent, and social mission is fulfilled by using the EU financing.

EU subsidies are distributed within competitive calls for proposals addressed to interested parties in developing SEEs. These parties, having in fact the role of facilitators, should use the EU financial support received through the MA in identifying interested persons to develop new SEEs, in training and counselling these persons with the aim of creation and operationalisation of SEEs. These facilitators, acting as entrepreneurship scheme administrators of the minimis aid under the control of the MA, sign subsidy minimis aid contracts with an approved number of SEE's they have created. Within these contracts, the facilitators are granting the minimis aid, are monitoring the activities and disbursing sums. In December 2023, according to the public NEA's National Register of the SEEs: <https://www.anofm.ro/index.html?agentie=&categ=9&subcateg=1&idpostare=28756>, in all Romania a number of 2915 legal entities were registered having also the quality of SEE. Analytical evidence on VAT number, date and county of incorporation is available here for each SEE, but the other sections are not always filled in. Unfortunately, less technical information about SEE's activities is publicly available at national level, except some specific SEE's internet presentation. It may be expected that SEEs activities are more likely promoted and acknowledged at local level, nearby their target groups, or they do not function any longer even if they are still registered as SEE. The quality of SEE may be loosened by the way of a simple request made by the interested legal entity to the NEA, announcing that the entity is renouncing so at its social mission, continuing or not to act as a legal entity according to the common law. There is no limitation for the SEE's activities, except of course the generally ones that cannot be financed by European subsidies, according EU regulations in force.

The importance of the sector, as well as of the necessary due attention in public spending is arisen by the announcement made by the MA in 2020, during COVID19 pandemic period, about its decision in over contracting the sector, meaning granting more than 4 times and a half of the initial estimate to the social economy facilitators, in order to allow the creation of more SEE than initial predicted as necessary. According to this, were expected to be contracted 116 financing contracts with a total value of 325.82 million euro, more than the initial amount assumed of 70 million euro. The announcement is still active on the MA webpage at: <https://mfe.gov.ro/am-pocu-publica-lista-finala-a-proiectelor-selectate-aferenta-apelului-pocu-449-4-16-consolidarea-capacitatii-intreprinderilor-de-economie-sociala-de-a-functiona-intr-o-maniera-auto-sustenabila/>. The list of the facilitators and expected grant values may be also download from this page. The guidelines for applicants, also available online at: <https://www.fonduri-structurale.ro/fisa-proiect/2/programul-operational-capital-uman/406/pocu-4-16-sprijin-pentru-infiintarea-de-intreprinderi-sociale> is establishing as a core condition for the SEE to create jobs within the new established entities, about one new job for each 20,000 euro minimis aid granted, but not more than 100,000 euro per SEE. The same guidelines are stating that the facilitators of SEE creation may use at least 70% of their grant contract to be reimbursed in favour of the new created SEEs. Having this information, in approximate numbers, as a direct result of this call for proposals, in Romania should have been incorporated and financed somewhere between 2300 and 2850 SEE, subsequently creating new jobs in the social economy sector in-between 10,000 to 11,500. The facilitators received for all measures in preparing and incorporating SEE a total amount of about 105 million euro, meaning a little less than 10,000 euro per new job created in social economy, or about 35,000 euro for each SEE they created. The number of the new created SEEs is consistent with the total number included in NEA's public register, so it may be assumed that the largest part of Romanian SEE was

created under the pattern of the shortly described above call for proposals the MA launched in 2018 and later over contracted in 2020.

2. Sustainability in social economy sector

In the social economy sustainability should be linked by the lasting impact an intervention is delivering to the target groups in particular and society in general, as a continuous activity. Efficient long lasting social activities should so define the sustainability in social economy sector. The link between financial support (input) and the impact (the registered change since the intervention is presented below.

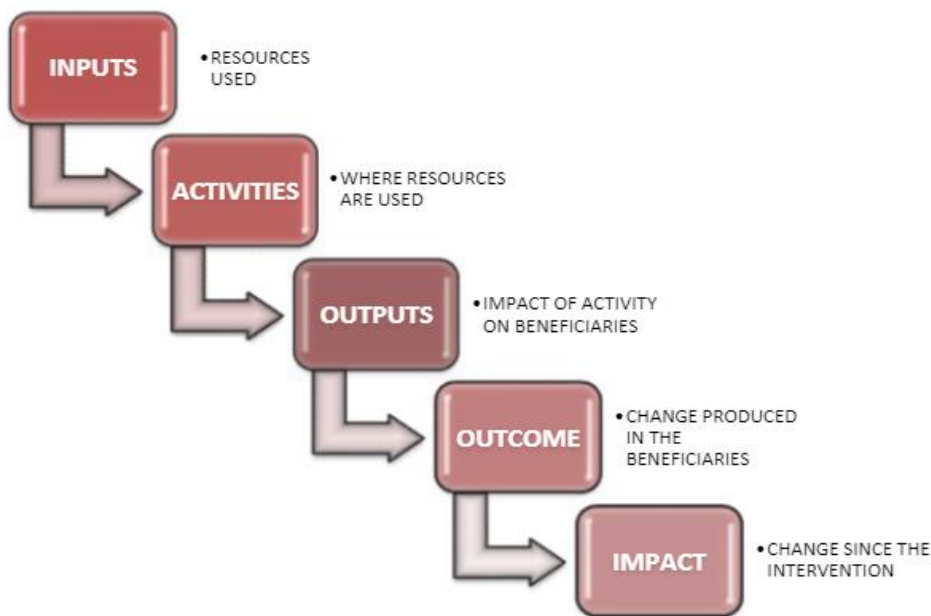


Figure 1: Terminology of social enterprises in their operational process.

Source: (Ballester-Miquel, et al, 2017)

The use of adequate resources, financing relevant activities, creating impact to beneficiaries, leading to a change in their situation, eventually to a lasting changing is simply describing the sustainability of social economy sector. Justifying the need of inputs in social economy sector is more than simply financial, as in business sector is, but socially explained with reliable indicators of the return on investment, not in accounting terms, but rather in the sense of social balance where outputs and outcomes are valued (Ballester-Miquel, et al, 2017).

The described model of efficiency, and also sustainability, offers the advantage of considering social impact, as well as other factors limiting or enhancing it. Others approaches are considering for interpretation the return of public investment in a simpler way, by measuring the rate of return of SEEs over a limited period of time (Oliński, 2020). They calculate the amount of payments to the national budgets and are comparing with the initial public investment in SEE, assessing so strictly financially the efficiency of public intervention.

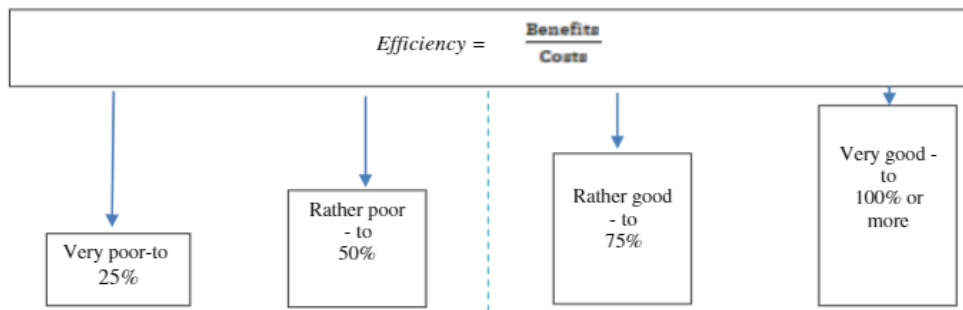


Figure 2: Thresholds for assessing efficiency of the public financial support.

Source: (Oliński, 2020)

However different efficiency-oriented models and approaches, the capacity of delivering long lasting services is crucial, and, for this financial resource is critical for restarting over and over again the cycle of delivering goods or services to the target groups, the disadvantaged people.

In Romania, the social economy sector is at its very beginning, since the corresponding regulation was issued in 2015. Some public investments were put in the market, but unfortunately, signs are showing that SEEs are not functioning quite well, and their capacity on restarting new cycles of delivering goods or services to the disadvantaged people is jeopardise.

3. Research methodology

Social economy may play an important role in future European economy, if relevant data is available, collected and analysed for a sound management decision process regarding to SEEs creation, subsidize and monitor as well. Romania, as a significant part of EU should monitor its social economy sector, further acting according the analysis findings. Natural responses related to the large amount of EU expenditure in SEE are to be expected from the involved parties, the main actors of the social economy sector: the NEA, the MA and the last but not the least, the facilitators of SEE creation in Romania. There are the research questions trying to extract relevant answers to the subject:

- Are SEE's businesses sustainable?
- Are the SEEs financially self-sufficient?
- Is the expenditure structure supporting sustainability?

As long as detailed data regarding SEE is unavailable, answers at the above listed questions are searched through the use of forensic accounting techniques: reviewing the existing public information on public and private sites, analysing the summary of financial statements of the SEE, as it may be found on the Ministry of Finance online database, and interpretation of the evidence so gathered. Conclusions may lead to improvement opportunities in social economy sector development, by outlining the sustainability issue in the purpose of future corrective actions. Sources of information to fundament answers are public, available relevant data was used from the MA internet site, the NEA public SEEs registry, the Ministry of Finance public database and a private NGO internet site specialized in promoting financial opportunities arisen by the European funding in Romania. Because of the large extent of data needed to analyse the national level, a selection of data was used, regarding SEEs incorporated in Maramureş County, in Romanian Northwestern Development Region, bordering Ukraine. This selection is motivated in the largest number of SEE this county has incorporated in the region, and the second largest in the country as for 172 entities, representing 5,9% of the total SEEs in Romania. Romania has 41 Counties,

Maramureş County has a contribution to Romanian GDP of 1,7% and a GDP/capita reported to the national of only 72,9%, so it may be assumed that in this County the need for services SEEs may deliver under the market failure are expected. Analysing the public list of successfully facilitators it can be observed that For Maramureş County a number of 5 financing contracts were granted, for a total value of 13,87 million euro, representing 4,26% of the total. This research is only a case study, regarding SEE in Maramureş County. Findings are representative for Maramureş County as data from all SEE population has been collected and analysed. In some extent this study conclusions may be relevant at country level, but to confirm this, furthermore data has to be analysed from all over the country.

Data about location (Maramureş County), VAT number and year of establishment of SEEs was collected from the NEA public register, then additional financial data was collected from the public database of the Ministry of Finance, for each VAT number. Because of the deadline for submitting financial statements for the fiscal year 2023, which is later than the deadline for this paper, not all population presented to the Ministry of Finance the 2023 financial statement, so latest information it was used for both layers, meaning information extracted from the publicly financial statements of the year 2022. Microsoft Excel has been used to generate relevant reports.

Data was divided depending of the SEE year of incorporation and by the type of the legal person incorporated. 9 of 172 SEEs (about 5% of the total) are established as NGO, not for profit organisations, forms of organisations really suitable for a SEE profile of social services providers. The rest of about 95% are organised as profit making organisations: limited liability company (SRL).

Were eliminated from the analysis the entities created earlier than 2020 (15 SEEs) and later than 2021 (7 SEEs), because of the lack of public information regarding their scope and pattern for incorporation. The remaining population was divided into two layers, the 2020 incorporated (51 SEEs) and the 2021 incorporated (85 SEEs). In the purpose of conclusions representativeness, and considering the annual turnover as the main indicator of SEE's volume of activities, from each layer were removed the outliers, so were eliminated the smallest values of annual turnover (less 2,000 euro) and the greatest, considered as non-consistent with the average sample turnover. The remaining 2020 layer consists of 37 sets of data and the 2021 in 71 sets of data, corresponding to SEEs having an activity that describes the normal for these entities. These data were kept for further analyse, conclusions for layer 2020 may, in some cases, be considered as forecasting the reality the layer 2021 will face next year. In the purpose of estimating the financial health of the SEE, the Altman Z-score method was applied. (Gelashvili, 2020).

4. Results and discussions

4.1. About SEE sustainability

The NEA public register of SEE includes data of all incorporated entities in Romania having also the quality of SEE, some of them may be incorporated earlier then 2015, the year when the SEE law entered into force, but these are only exceptions, most of the SEE were established and incorporated with the occasion of their owners' participations into relevant projects financed by the MA in 2020, 2021 and 2022 An examination of the December 2023 latest version of the national register of SEEs allows collecting relevant data. The number of declared active SEE in Maramureş County is 172 and the first SEE certificate has the number 1 and the last 177. It may be concluded that 5 SEE renounced at their quality. A further analyse of financial data reveals that other 13 legal entities from the total of 172 are even radiated, or they suspended their activity, or they simply didn't submit annual financial reports to the Ministry of Finance, meaning these entities are no longer active, so they are no longer fulfilling their social mission, so a total of 10,46% are formally not continuing the

social activity. As for the rest, by examining the collected data from their financial statement (mfinante.ro), it was found out that in 2022 after the first year of activity (layer 2021) 6 SEEs had an activity of less than 2000 euro per year, and in the second year of activity (layer 2020) 8 SEEs had an activity of less than 2000 euro per year, meaning in fact that those SEEs are not working, are not delivering activities for their social mission, even they stay registered as so. It may be concluded that 8,14% from the total of 172 SEEs in Maramureş County practically are not delivering according their social mission, even if they stay incorporated as SEEs. As a conclusion, according to the latest financial available data (2022) about 20% of the total SEEs in Maramureş County are no longer providing for their social mission, so 20% of the SEEs are not sustainable. Sustainability issues may be further analysed and discussed only for remaining 80%.

4.2. About financial SEEs self-sufficient ness

The most significant indicator for self-sufficient ness is the equity value. If negative means that the SEE cannot fulfil its financial obligation even in the event of asset liquidation, situation which implies an even less value of the assets, the liquidation value. The financial statements are presented in the hypothesis of continuing activity, so assets value is different presented, bigger than the liquidation value.

As for equity, in the 2020 layer 26 SEEs have negative value for equity, meaning about 51% of the total layer population. The 2021 layer presents 39 SEEs with negative equity, meaning about 46% of the total layer population. A conclusion may be extracted here that even in the first year of activity the number of SEEs with negative equity was representing a strong minority (46%), in the second year the number of SEEs with negative equity may become a majority (51%), Considering that these SEEs were acting in similar conditions, in the same geographical area, having the same pattern of incorporation (which is a minimis subsidy originated form European funding) it may be concluded that in the next year SEEs situation will worsen, meaning the number of SEEs presenting a negative equity will increase, so it will be harder to SEEs to continue their activities without financial support.

Another indicator, less representative than the equity is the profit. As long as a firm has a profit, its activities may continue, even in the condition of negative equity.

As for profit, in the 2020 layer we find 28 SEEs registering profit (54,9%) and 23 with losses. In the 2021 layer we find 57 SEEs registering profit (67,06%) and 28 with losses. It may be concluded that profit was registered in the first year of activity by relatively more SEEs than in the second year (decreasing from 67,06% to 54,9%).

As for debts, the 2020 layer cumulates for the 37 SEEs corrected population the medium debt/ SEE is 25,132 euro. The 2021 layer cumulates for its 71 SEEs corrected the medium debt per SEE is 17,698 euro. It may be concluded that there is a substantial effort of SEEs promoters (owners) in sustaining the activity. Both layers are presenting, as a whole, negative value of equity, so debts of SEEs are generally larger than the balance sheets assets, taking into consideration also the minimis aid.

All these corroborated conclusions, may lead to an image of general financial distress for SEEs, difficulties that may lead eventually to SEEs closure.

In order to confirm this finding, the Altman Z-score method was applied for all 2020 and 2021 population (Gelashvili, 2020), as well as for the corrected samples of 37 and 71 SEEs using the formula:

$$Z' = 0.717X_1 + 0.847X_2 + 3.107X_3 + 0.420X_4 + 0.998X_5$$

Where: Z' is the index of bankruptcy;

X₁= (Current Assets-Current Liabilities)/Total Assets;

X₂= Retained Earnings/Total Assets;

X₃= Earnings before Interest and Taxes/Total Assets;

X₄= Book Value of Equity/Total Liabilities;

$X_5 = \text{Sales/Total Assets}$.

Results of Z's score show that, in practice, companies can be classified into three different areas:

$Z' > 2.9$ - "Safe" zone; it means that the company has no risk of bankruptcy.

$1.23 < Z' < 2.9$ - "Grey" zone; it means that company could have problems to survive in the next period.

$Z' < 1.23$ - "Distress" zone; it means that there is a high probability that the company will go bankrupt.

According to the Z-score formula, the sample of this research has been classified by these three groups (Safe; Grey; Distress), and the results for each of the sample population (2020 and 2021) are presented in the table below.

Table 1: Index of bankruptcy classification for 2020, 2021 layers and total SEEs

	Safe zone	Grey zone	Distress zone	Total
2020 Number of SEEs	9	6	36	51
2020 (% of SEEs)	17.65%	11.76%	70.59%	100%
2020 Number corrected of SEEs	6	5	26	37
2020 (%) corrected	16.22%	13.51%	70.27%	100%
2021 Number of SEEs	0	13	72	85
2021 (%)	0.00%	15.29%	84.71%	100%
2021 Number corrected of SEEs	0	9	62	71
2021 (%) corrected	0.00%	12.68%	87.32%	100%
Total of SEEs 2020 + 2021	9	19	108	136
Total of SEEs 2020 + 2021 (%)	6.62%	13.97%	79.41%	100%
Total of SEEs 2020 + 2021 corrected	6	14	88	108
Total of 2020 + 2021 corrected (%)	5.56%	12.96%	81.48%	100%

Source: own processing of financial data through Altman Z-score method

As a conclusion, financial SEEs self-sufficient ness is not confirmed according to existing 2022 financial data for about 80% of the existing SEEs, here being present a high risk of bankruptcy. The risk of bankruptcy is also present for about 13% of the SEEs; they will have problems in surviving in the future, but this doesn't mean they will necessarily go bankrupt. Only 6% of the SEEs are found in the safe zone, so they are far away from the bankruptcy zone. It may conclude that this share of SEEs is originated from 2020 population, so there is a possibility that becoming mature, the SEEs will be more viable, hypothesis confirmed by the migration seized from the distress zone to grey and even safe from the year 2021 compared with the older sample of 2020. This conclusion that may be further confirmed (or not) by the 2023 financial statements data, not yet all available now.

4.3. About expenditure structure supporting sustainability

Examining the financial data publicly presented by the Ministry of finance for the selected VAT numbers, corresponding to SEEs, it may be concluded that together with the appropriation of the legal status of limited liability company, the SEEs promoters have also a preference for acquiring fixed assets from the minimis aid originating from the EU subsidies. For the 2020 layer the average is about 47,158 euro/SEE, approximately similar with the 2021 layer, here the average of fixed assets is about 47,516 euro/SEE. This similarity is normal, because all these SEE; were established under the same circumstances, following the same pattern. It appears that more than 50% of the minimis aid is spent on fixed assets, to be used for generating income and eventually profits to be reinvested in the firms (also social) activities. Comparing the income in advance with the fixed assets values for the 2020 layer, as the second year, after the minimis aid is consumed,

it may reveal the average amortization period of the fixed assets acquired: 12 years, so there is a preference for fixed assets with long period of amortization.

Further examining data presented from the annual financial statements (2022), for a corrected series of 2020 layer consisting of 37 sets of data and the 2021 layer consisting of 71 sets of data, corresponding to SEEs having an activity that describes the normal for these entities, a relatively large number of employees is seized (3.89 employees per SEE in 2020 layer and 3.54 employees per SEE in 2021 layer). Necessary funding for salaries/SEEs in the first year (layer 2021), calculated at the minimum legal level in Romania is 23016 euro/SEE, and for the second year (layer 2020) is 25338 euro/SEE, in the hypothesis of full time for the new jobs created within the SEEs.

This number of employees per SEE indicates the value of a minimis average aid per SEE, as 85,000 euro. The estimate of budget breakdown for 2021 series is: Fixed assets 47,158 euro, Salaries: 23,016 euro, and the rest of 14,468 euro is dedicated to other expenses, including current assets, services, etc.

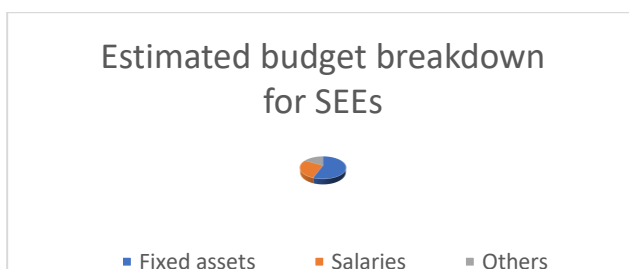


Figure 3: Estimated budget breakdown of a minimis aid supported SEE

Source: own processing of publicly presented data as described by the author

As for this budget breakdown, taking into consideration the obligations in accomplishing social mission and the interdiction of distribution the profit to the shareholders, values of expenditures for salaries are fully justified, and they should be kept at least at the same level. For maintaining this value in the years to come, the SEEs should gain annually at least the amount due for salaries and miscellaneous others, so a minimum of 32,661 euro per year. Examining the publicly available financial data for the 2020 series, the one in the second year of activity, it reveals that only 13 of 51 SEEs (25.5%) do realize this level of revenues, so for the rest is expected that keeping the jobs is possible only by increasing debts. In conclusion, with the determined structure of expenses, only 25% of the SEEs may become sustainable.

5. In conclusion

It has been observed a prevalence of 95% in incorporating limited liability companies as SEEs, but NGOs, potentially more suited for developing activities oriented to disadvantaged groups. It has also been observed that about 20% of all ever registered SEEs in Maramureş County are even closed or suspended their activity at December 2023. As for the rest, about 80% of functioning SEEs are in high risk of bankruptcy (debts, negative equity, small turnovers, losses), and only about 5% are viable, financially sustainable. The rest are in the grey zone. As for their activity, less information is available. Some questions may arise regarding the causes of this reality, about prevalence of limited liability company over the NGO (more suitable for delivering social activities), about relevance to social economy of some activities chosen to be financed (ex: leasing vehicles and goods, engineering activities, preparing sites for buildings, software production, photography etc.), about the support on identifying risks received by the social entrepreneurs from the facilitators, about

of the on-going support received, etc. These should be taken into consideration for further analysis.

Social economy sector is vital in creating opportunities for disadvantaged people, so it must be monitored, analysed, encouraged and supported. The state, through the UE financing programs financed in the years 2020 and 2021 the creation of a large number of social economy entities (SEEs), making expenses of no less than 325 million euro, but, as described above, the application of forensic accounting techniques revealed a depressing reality.

Without any external intervention, seeing the actual trends, the obligation of maintaining jobs is not sustainable, the debts for the second year of activity are 40% bigger than in the first year, SEEs actual initiators are in debts cumulating about 30% of the received grant after the first two years of activity. With this level of debts, as well as with the identified level of bankruptcy risk, measures of SEEs in managing the closure risk might be expected in the future, such as: reducing from full time to part time or even the number of jobs, renouncing at the SEE quality, and so, to all assumed obligations after the contract mandatory period. Without another further financial help these are the logical measures to be taken by the entrepreneurs who already lent important sums to the new created firms.

Closure of existing entities, excessive debts and lack of ongoing support for these entities should be considered by deciders in adjusting policies and refocusing on the most relevant activities and disadvantaged target groups.

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