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PRESS RELEASES

Non-profit, private or public?

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By proposing a draft **Non-profit Financial Operations and Accounting Act, the Government has made a major step forward in defining more clearly the activities of non-profit organisations, and raised the issue of distinguishing between these organisations on one side and private and public sector organisations on the other. The Act Proposal is currently in parliamentary procedure for discussion and adoption.**

Two consequences of the Act. While the main *goal of the Act Proposal* was to regulate comprehensively the system of financial operations, accounting and oversight of the financial operations and accounting of non-profit organisations (NPOs), two consequences of the Act are even more interesting. First, the Act makes it possible to recognise and distinguish between the profit-making and non-profit-making activities of the existing NPOs. Second, it enables the Government to determine more clearly the status of some NPOs as budget or extra-budgetary users, or companies in majority state ownership. This can be best explained by the example of state agencies and public companies.

The Non-profit Organisations Register kept by the Ministry of Finance is the first place to get information on the type, scope and nature of an NPO's activities. The structure of the NPOs within the Register provides little basis for distinguishing between non-profit organisations and those subject to corporate income and value added taxes, or organisations that have the status of budget or extra-budgetary users and state-owned companies. Hence, many profit-oriented NPOs pursuing economic activities (such as sports associations, notably football clubs) are lumped in with religious associations and humanitarian organisations, foundations, chambers, entrepreneurs associations, etc. Included are also institutions providing public services which are financed from earmarked sources of revenues (e. g. tourist boards and state agencies) and are not classified into the government sector as budget or extra-budgetary users. They provide a good example ambiguity in defining the status of state agencies and some companies performing public functions; they have the status of NPOs and could be classified as budget or extra-budgetary users or public companies. This terminological, but also institutional confusion is very often an obstacle to a clear differentiation among public sector institutions and to their reform.

Improving the financial transparency of non-profit organisations. The proposed Act will improve the statistical monitoring of NPOs by imposing the obligation to submit financial statements tailored to the amount of their income and value of their assets. The financial reports of NPOs will be publicly disclosed in the current Register kept by the Ministry of Finance. Those NPOs whose revenues exceed 10 million kuna will be obliged to publish reports on the audit of the annual financial statements. The NPOs with a total income exceeding 3 million kuna will be obliged to provide access to the financial statements for the previous year. Part of NPOs will be allowed to continue with the single-entry bookkeeping provided, however, that they compile summary annual financial reports (unlike the NPOs doing double-entry bookkeeping), and provided that they submit quarterly reports.

Profit tax payment and separate accounting records. According to a tax statement issued by the Tax Administration, subject to profit tax will be any NPO whose annual income or receipts from an economic activity are lower than 230,000 kuna. Despite being subject to tax, such an NPO will continue to keep accounts for its entire operations as a non-profit entity. However, for tax assessment purposes, it will also be obliged to keep separate tax and accounting records for its economic activity. An NPO whose assets and annual income in the last three years are worth less than 230,000 kuna will not be subject to double-entry bookkeeping or accrual-basis accounting. For this purpose, however, the legal representative of the NPO will have to adopt a decision allowing the NPO to apply single-entry bookkeeping and cash-basis accounting.

Establishment of a company. One of the key provisions aimed at separating the economic activity from the non-profit activity will require from an NPO which derives an annual income of over 230,000 kuna from an economic activity, to establish a company (or another form of association other than a non-profit organisation). Economic activity is defined as the sale or exchange of goods and services in a market and under market conditions for the purpose of deriving a profit or other benefits that can be economically assessed. By pursuing such an activity, an NPO would gain undue advantages in the market. Therefore, a company should be established for such an activity. An NPO pursuing the economic activity of providing rental and leasing services will not be required to establish a company (or another form of association other than a non-profit organisation) for that particular economic activity. The tax liability of such an NPO will be assessed through a tax statement issued by the Tax Administration.

FUTURE STATUS OF NON-PROFIT ORGANISATIONS PROVIDING PUBLIC SERVICES

As an important consequence of the Act Proposal, part of state agencies, non-profit organisations and companies will have to change their status to become public sector institutions – budget or extra-budgetary users.

Who is who in the public sector? According to the Budget Act, **budget users** are government bodies, institutions, minority self-government committees, budgetary funds and local self-government bodies whose expenditures for employees and/or material expenses are financed from the budget. **Extra-budgetary users** are extra-budgetary funds, companies and other legal entities in which the government or a unit of local self-government exerts a decisive influence on the management. **Extra-budgetary funds** are actually extra-budgetary users (legal entities) established under the law and financed from dedicated contributions and other revenues. Some of the state agencies or companies which currently have the status of non-profit organisations could fall under each of the above mentioned definitions.

Non-profit state agencies that became budget users before 2014. The government has moved 34 extra-budgetary non-profit agencies to the State Budget. Their total revenues and expenditures have been transferred to the Budget, and their financial operations are carried out within the budget accounting system. The audit of their operations is carried out by the State Audit Office. However, part of state agencies having the status of non-profit organisations remained outside the scope of the budget.

Non-profit state agencies as potential budget users. There are six state agencies in Croatia having the status of non-profit organisations¹. Based on a Government decision, these agencies could be immediately classified as budget or extra-budgetary users. According to the **Government's Economic and Fiscal Policy Guidelines for 2014-16**, they are supposed to be included in the State Budget and operate through the State Treasury system. The agencies even meet the definition of extra-budgetary funds, because they are financed from dedicated revenues (mainly compensation); given their valuable financial assets and low liabilities, they would probably improve the financial position of the State Budget.

A non-profit organisation, a budget user or an extra-budgetary user? The Public Company Croatian Waters and State Agency for Deposit Insurance and Bank Rehabilitation (DAB) are two non-profit government institutions enjoying the status of extra-budgetary users. Both of them receive

¹ They include: Electronic Media Agency, Agency for Explosive Atmosphere, Croatian Financial Services Supervisory Agency, Croatian Compulsory Oil Stocks Agency, Croatian Post and Electronic Communications Agency and Croatian Civil Aviation Agency.

dedicated revenues. The Public Company Croatian Waters could actually keep its accounts as a company (and thus retain the status of an extra-budgetary user), because it generates profits which are used to improve the company's activity. By contrast, the DAB could easily become a budget user and operate within the State Budget through the Treasury system.

A company, a non-profit institution, a budget user or an extra-budgetary user? There are two agencies which have the status of companies; they are neither non-profit organisations nor extra-budgetary users, but are institutions performing some public functions in the name and for the account of the government. Financial agency, for example, performs part of its activities in the name and for the account of the government, for example the central wage calculation, treasury operations, etc. The Agency for Medicinal Products and Medical Devices is a company that generates substantial own dedicated revenues, which could easily be included in the State Treasury system, with the Agency being transformed into a budget or an extra-budgetary user.

The new Act provides solid, but an insufficient basis for a better definition of the non-profit organisations' activities. Much more significant is its potential positive influence on improving the classification of public sector institutions. However, an optimum definition of the non-profit and public sectors and a clear determination of the sectoral affiliation of current NPOs should be based on high-quality criteria and, especially, on more resolute political decisions. Resolving the status ambiguities is important for identifying institutions subject to taxation, as well ensuring a level playing ground and equal conditions for all market participants. It is further important for the Government, as a means to improve its public sector wage policy, and particularly, the state property management, as well as the running and management of government finances through the State Treasury.