

Challenges of Establishing and Operating Social Enterprises

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SUMMARY

A social enterprise is an organisation that is financially self-sufficient, like a conventional commercial enterprise. However, its primary objective is to achieve the set social purposes and goals that it considers to be important rather than maximizing profits. This definition implies that social enterprises show similarities with both civil organisations and for-profit enterprises. Consequently, there are specific challenges related to their foundation and accounting. Since maximizing profits and social and environmental benefits are equally important during the operation of these enterprises, the profits they generate are used to achieve further social goals and are not distributed to individual shareholders. Thus, income from supplying goods and services constitutes the major source of their income. Successful social enterprises generate profit which is reinvested to subsidise the social mission they have defined. Their assets can often be used for community purposes exclusively.

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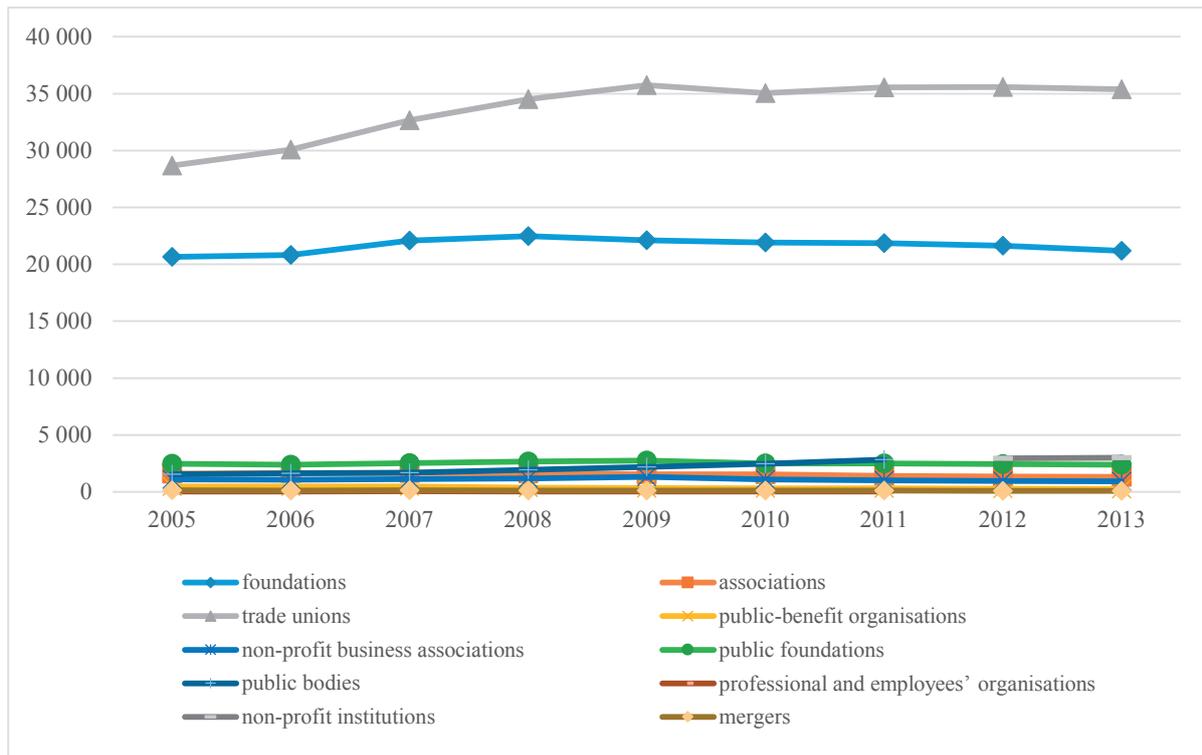
INTRODUCTION

In this paper I present the establishing and operating social enterprises. It was created within the framework of the T-model project, concentrating on the social entrepreneurship opportunities of deprived regions. This special issue includes papers presenting research carried out on similar issues: sustainable enterprise models (Illés 2016); sustainable accounting (Demény & Musinszky 2016); the SLEM model created to measure the market potential of local goods supplied by the entrepreneurs of the Cserehát region (Bartha & Molnár 2016); the place of public works in the employment model of the Cserehát region (G. Fekete 2016); and route-based tourism product development (Nagy & Piskóti 2016).

There are two legal forms for social enterprises. They can be founded in the form of a non-profit business organisation or in another organisational form (a foundation or an association). Figure 1 shows the number of non-profit organisations in Hungary by structure.

The figure clearly illustrates that social enterprises operating in the form of non-profit business organisations that are considered to be entrepreneurship are rare. Thus, keeping books and reporting is governed by the principles formulated in the Act on Accounting. Other types of business organisations (especially foundations and associations) are more popular. Apart from accounting standards, other legal acts to be applied are as follows:

- Government Decree 224/2000 (XII.19.) on the reporting and bookkeeping obligations of other organisations as provided in the Accounting Act
- Act CLXXV of 2011 on Right of Association, Non-Profit Status and the Operation and Funding of Civil Society Organisations
- Act CLXXXV of 2011 on the Court Registration of CSOs and the Relative Procedural Rules
- Government Decree 350/2011 (XII.30.) on Certain Issues of CSO Financial Management, Fund Raising and Public Benefit Status
- Act V of 2013 on the Civil Code.



Source: author's own elaboration based on the data from www.ksh.hu

Figure 1. Number of non-profit organisations in Hungary by structure (2005-2013)

Reporting and bookkeeping obligations of other types of organisations as provided in the Accounting Act (foundations, associations, public benefit organisations and other types of organisations established under the right of association) – authorised by law – are stipulated by Government Decree 224/2000 (XII.19.), which has been amended several times, and by other government decrees. The aforementioned government decrees govern specific regulations - obligations of other types of organisations - that cover particular organisations and differ from the rules for entrepreneurs, whilst not being contrary to the fundamental principles of the Accounting Act. Issues not stipulated in government decrees are regulated by the principles of the Accounting Act. Consequently, reporting and bookkeeping obligations of organisations (in addition to particularities defined in government decrees) must also comply with the (amended) principles of the Accounting Act not specified in government decrees.

LITERATURE REVIEW – FUNDAMENTAL RULES ON CIVIL SOCIETY ORGANISATIONS

The term civil society organisations has the following meaning (Act CLXXV of 2011):

- civil societies that
 - can be established by natural entities

- are established to promote common purposes of non-economic interest and to harmonise activities meeting community-related purposes
- are established without capital contribution
- associations, other than parties, registered in Hungary
- foundations.

A civil society organisation may not be established for the sole purpose of carrying out economic-entrepreneurial activities. This is an organisation formed for primarily economic-entrepreneurial activity if its total annual income from this activity amounts to or exceeds 60% of the total income. Economic-entrepreneurial activity is an activity that is performed in a businesslike manner, aims at or results in acquiring income or property, except for (Act CLXXV of 2011):

- donations to social organisations – for the purposes stipulated in the instrument of constitution – are an instrument (products or assets) or service provided to a donor without requesting any financial compensation providing that services and goods given to a donor are not considered to be financial compensation whose value does not exceed the limit of 25% of the minimum wage;
- monetary or non-monetary contributions provided within the framework of fundamental purpose-related (public benefit) activities defined in the instrument of constitution and generating income for civil society (public benefit) organisations (legislation stipulates the classification of associations, foundations and other organisations by purpose of their activities. Under the law, the performed activities may be

cultural, information, communication, religious, sports, recreation and hobbies, educational, research, healthcare, social, civil protection, fire extinguishing, environmental protection, protection of human rights, public security, donation distribution, non-profit association, international, political and others);

- public benefit activities, defined as activities that serve the public directly or indirectly, are stipulated in the instrument of constitution and contribute to meeting the common needs of the society and individuals.



Source: author's own elaboration

Figure 2. Provisions on bookkeeping obligations of civil society organisations

Activities performed by other types of organisations are as follows:

- basic activities that include any kinds of activities that are necessary for realising purposes formulated in the instrument of constitution and purpose-related activities (activities) indicated in the governing documents as well as support, contributions and membership fees related to this activity (these activities). (These activities may also generate income but this income shall be in balance with expenditures, because the activities are not conducted with the aim of generating profit).
- entrepreneurial activities aiming at generating income and assets, as well as economic activities resulting in this, which are not classified as income coming from performing basic activities. (Apart from conducting purpose-related (public-benefit) activities, civil society organisations may perform economic-entrepreneurial activities which are not directly related to the purpose of the organisation set in the governing documents if these activities do not directly jeopardise the set purpose).

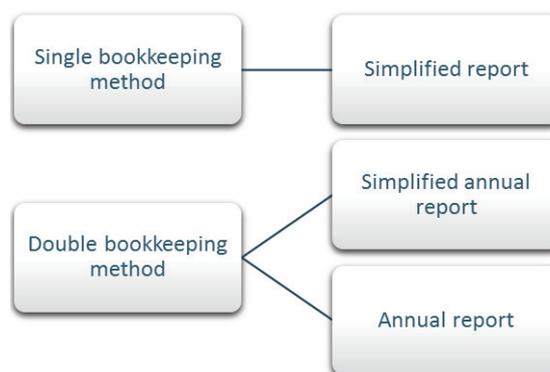
Only other types of organisations performing entrepreneurial activities need to consider the threshold set on the total income. Organisations not performing entrepreneurial activities produce simplified reports or simplified public benefit reports. The threshold is set at the total income (from entrepreneurial and non-entrepreneurial activities) level of 50 million HUF for organisations carrying out entrepreneurial activities. This means that the annual income deriving from both entrepreneurial and purpose-related activities does not

permanently exceed the annual limit of 50 million HUF in two consecutive calendar years. The aim of this limitation is to allow other small and medium-sized organisations pursuing entrepreneurial activities to prepare simplified reports and exclude large ones (Pál, 2003).

The bookkeeping methods are as follows:

- single bookkeeping method
- double bookkeeping method.

Foundations and civil organisations awarded public benefit status may apply only double bookkeeping method.



Source: author's own elaboration

Figure 3. Reporting obligations of civil organisations

Pursuant to Government Decree 224/2000, the types of reports chosen by other types of organisations can be grouped as follows:

- simplified report (a simplified balance sheet specified in Annex 1 to the Government Decree and appropriation of profit and loss under Annex 2 of the same decree) in the case of the single bookkeeping method,
- simplified annual report (a balance sheet as specified in Annex 4 to the Government Decree and a profit and loss statement complying with Annex 5 of the same decree and supplement to the law) in the case of the double bookkeeping method.

Organisations can prepare annual reports. Simultaneously with approving the report, public benefit organisations must prepare a public benefit report that is approved by their highest bodies. Organisations complete and electronically submit a Public Benefit Annex in a special format and the minister in charge of social and civil relationships discloses this.

The Public Benefit Annex shall contain the following data:

- a list of public benefit activities pursued by the organisation
- target groups and results
- data and indicators required for winning the public benefit status
- the way assets are used
- grants for a public benefit purpose

- the amount of benefits granted to officers and the list of chief officers receiving the grant.

Public benefit organisations must deposit and publish their reports approved by the competent body, the public benefit report and the auditor's report no later than the last day of the fifth month following the balance sheet date of the current fiscal year.

If a civil society organisation has its own website, the reports must also be published on the organisation's website and made available to public until the publication of the data related to the second fiscal year. If the organisation fails to comply with publication provisions or remedy the publication deficiencies within a period of one year, the court may notify the prosecutor's office in order to conduct an inspection.

Other types of organisation must hire a chartered accountant or a certified auditor to perform activities related to accountancy services if the organisation conducts entrepreneurial activities and generates income of over 5 million HUF from these activities and the income has been on average more than 10 million HUF in the two business years prior to the current business year (if this condition is missing, then the expected income in the current business year is taken into account) (Kántor, 2006).

In the event that the annual income of a public benefit organisation exceeds the annual limit of 50 million HUF, it is mandatory to establish a supervisory body separate from the governing body, even if such obligation is not prescribed by other laws. The supervisory body determines its own internal procedures and order of business, which is described in the instrument of constitution. No person shall be a chairperson or a member of the supervisory body who is a chairperson or a member of the governing body, is a relative of theirs, is employed by it or stands in another legal relationship aimed at employment, receives targeted grants from a public benefit organisation, except non-financial services available to anyone without limitation and targeted grants corresponding to the founding document granted on the basis of the relationship between civil society organisations and their members. (Government Decree 224/2000)

All public benefit organisations must employ an independent auditor, as must all other types of organisations that generate average income of over 300 million HUF in the two business years prior to the current business year. In cases where audit is not mandatory by virtue of some other legal regulation, other types of organisations have the right to decide whether to employ an auditor in order to review the reports or not. Several acts with similar or different contents stipulate provisions on performing audit activities, which make interpretation difficult (Füredi-Fülöp, 2014). Although the Public Benefit Annex does not constitute part of the report, the rules stipulating report compilations and governing report publications clearly declare that reports of these organisations comply with legislative requirements only

if a Public Benefit Annex is prepared and approved simultaneously with the report. The Public Benefit Annex is compiled on the basis of the register. The information kept at the register must coincide with the data in the report. Consequently, the auditor reviewing the report shall assess the annex content and establish if the annex content complies with the data disclosed in the report.

Public benefit organisations are no longer classified into two public benefit categories. An organisation registered in Hungary may obtain public benefit status if it meets the following criteria (Act CLXXV of 2011):

- The registered organisation contributes to meeting the common needs of individuals and society, that is to say, the data on target groups indicated in the Public Benefit Annex compiled in the previous year clearly show that the public benefit services provided by the organisation are available not only to the members of bodies, employees and volunteers of the organisation, but also to other people.
- The organisation has adequate resources, which means that it meets one of the following criteria regarding two business years prior to the current business year:
 - the generated annual average income exceeds 1 million HUF or
 - the aggregated after-tax results of two years (current year) are not negative or
 - the personnel costs – without benefits granted to senior officers – amount to at least one-fourth of the total expenses.
- If there is some evidence that the company has sufficient support from society, which means that it meets one of the following criteria regarding two business years prior to the current business year:
 - The received 1% of income tax donated by individual citizens is as high as 2% of the adjusted gross income indicated in the Public Benefit Annex or
 - costs and expenditures occurring in the interest of public benefit activities amount to half of the total expenditures of the average of the two preceding years or
 - at least ten public benefit volunteers permanently (in the average of two years) contribute to performing public benefit activities.
- The founding document shall include:
 - a description of the sort of public benefit activities, what public duties these activities are related to and the jurisdiction stipulating public benefit duties;
 - a statement that apart from the members of the organisation, other people may also receive public benefit services;
 - a statement that the organisation performs business activities only in the interest of realising its targeted objectives or public benefit objectives, without jeopardising them.

An organisation that qualifies as a public benefit organisation acquires its public benefit status after registration as a public benefit organisation. When the

report of the organisation is deposited, the court examines whether the conditions for retaining the public benefit status stipulated in the public benefit legislation are still fulfilled by the organisation. If the public benefit organisation fails to fulfil these conditions, the court cancels the public benefit status of the organisation and deletes the organisation from the register (Gottgeisl, 2012).

SPECIFIC FEATURES OF INCOME AND EXPENDITURES OF PUBLIC BENEFIT ORGANISATIONS

Civil society organisations continuously supply information about their operation to the general public throughout the year or at least once a year. For information purposes the legislation requires public access to the following:

- a report submitted to public registries;
- information about organisation operation and the use of donations by means of different information tools, especially organisation websites or newsletters.

*Table 1
Incomes, costs and expenditures of civil society organisations*

Incomes	Costs and expenditures
Income directly related to pursuing a purpose-related (as a part of public benefit) activity	Expenses directly related to pursuing a purpose-related (as a part of public benefit) activity
Donations	Operational costs of the managing body or organisation
Income derived from an economic-entrepreneurial activity	Expenses directly related to an economic-entrepreneurial activity
Other resources	Other expenses

Source: author's own elaboration

In order to ensure a long-term sustainable provision of services, civil society organisations follow the 'reasonable management' principle. They elaborate an annual budget in which revenues (donations and bequests, budget support, income derived from economic-entrepreneurial activity, non-monetary contributions and other resources) are equal to expenditures. They record and itemise incomes, expenditures and costs according to accounting standards as illustrated in Table 1.

Income Sources of Civil Society Organisations

Income by basic purpose:

- membership fees,

- contribution from founders and assets donated to organisations by founders,
- payments for pursuing activities listed in the public service contract,
- donations.

Grants are provided to organisations on the basis of an individual decision and can be used for a specific purpose. Monetary or non-monetary benefits are granted not primarily in return for payment, but to support specific projects or to cover operational costs of the supported organisation over a specific period of time. In contrast to benefits, donations to civil society organisations – for the purpose stipulated in the founding document – are financial tools that are not provided in return for payment. Sources of funding are as follows:

- state budget,
- local government budget,
- EU structural and cohesion funds,
- normative support,
- 1% of the personal income tax to a non-governmental organisation selected and stipulated by the taxpayer.

The received support can be used with limitations:

- targeted support can be used without requirements,
- the support provided to cover operational expenses cannot exceed the limit of 50% of the amount used for specific purposes (for instance, personnel costs or communications costs),

The amount of subsidy may be spent until the last month of the second year following the year of money transfer. (Lakatos, 2015)

Forms of support by method of financing:

- non-repayable grants,
- repayable grants.

Civil society organisations may receive loans and repayable grants if their debt obligation does not exceed the value of their assets. For the purposes of this provision, the balance of accounts payable and receivable as well as the value of the budgetary support is set in the decision made.

Support by purpose

- for development purposes

The amount of any financially settled grant non-repayable received for development purposes was shown as extraordinary income in 2015, but from 2016 it must be shown as other income, may be carried forward and should be shown as deferred income in compliance with changes in Act C of 2000 on Accounting. The termination of this and the depreciation of the asset are performed parallel and proportionally. In cases where assets are removed from the books, the grant shall be cancelled from accrued expenses and deferred income.

- for offsetting costs and expenditures

Any financially settled non-repayable grant which was received to offset costs (expenditures) and was not used to offset any costs or expenditures during the financial year shall be shown under accrued expenses and deferred income. Such a grant must be cancelled from accrued expenses and deferred income as soon

as the contract or financing agreement is performed or the costs or expenditures are actually realised (Musinszki, 2006). If the grant has not been settled financially, it cannot be shown as income. Thus, it may occur that costs, expenditures and income are shown in the balance sheets of different financial years. The financially performed advances received by the civil service organisation can be shown in the balance sheet as income only if the organisation has paid off the balance and supported this by invoices.

➤ for subcontracting purposes

Grants for subcontracting purposes are grants received by other types of organisations from founders or other organisations either via grants or in other ways and transferred further to organisations that directly perform the duties in line with the purpose of grants. Thus, the supported organisation shows the assets (liquid assets and other assets) received from other types of organisations as income. Other types of organisations must show such items (grants for subcontracting purposes, grants transferred further) as separate items in the profit and loss statement and in the profit and loss account. The amount shown as income for subcontracting purposes in the current accounting period but not yet transferred is to be shown under deferred expenses and incurred income by economic entities keeping double-entry books and under liabilities by economic entities keeping single-entry books. Other types of organisations shall show the grant for subcontracting purposes under other income if they keep double-entry books and under financially settled income in the case of keeping single-entry books. The transferred amount of such grant – depending on the bookkeeping system – shall be indicated as other expenses or shall be indicated and claimed as expenses. The transferred or forwarded grant is not recognised as a grant awarded to offset costs or grant for development purposes or financial equity transferred permanently.

The support that is due and applied for to tax authorities and to organisations stipulated by law shall be shown as income irrespective of its financial settlement status. If support related to the current year is applied for in the following year, before the balance sheet closing date at the latest, it should be recognised for the current year as deferred expenses and accrued income against income in the following year. The support received from resident or non-resident economic entities, natural persons, or from foreign organisations based on intergovernmental agreement or other contractual agreement shall be recognised as income when it is financially settled.

The support related to the current year and financially settled between the date of the balance sheet and the date on which it is drawn up must be shown as deferred expenses and accrued income against income. The expenses and income are released at the time of financial

settlement in the year following the current year. The grant related to the current year cannot be deferred if it is not settled between the date of the balance sheet and the date on which it is drawn up. If the support is financially settled after the balance sheet preparation date, the support is to be shown against the results of the year following the current year.

The economic-entrepreneurial income of civil society organisations includes of the interest on liquid assets in deposits and securities received from a financial institution, the issuer of the security and a part of the return of the securities issued by the government, which represents the income generated from economic-entrepreneurial activities in the total income. This means that the income in both cases shall be recognised without interests or returns.

Other income shall be recognised as other income under Accounting Act (income generated from selling tangible assets) or other targeted revenues.

Costs and Expenditures of Civil Society Organisations

Indirect costs and expenditures shall be divided between basic purpose activities (within these public activities) and economic-entrepreneurial activities in proportion to the incomes of different activities every year.

Targeted grants are financial or non-financial services provided by a civil (public beneficiary) organisation within the framework of its basic activities.

As for public beneficiary grants, the amount is tax exempt if it is paid to an individual entity from public benefit foundations and public foundation funds for public benefit purposes stipulated and in line with their charter or is allocated to cover studying expenses at educational institutions, research or studies abroad (scholarships), is allocated in the form of social assistance to entities in need, or is paid to participants of youth and recreational sports programs in the amount of maximum HUF 500 per occasion.

The tax-exempt public benefit grants encompass non-momentary benefits allocated for public benefit purposes from funds of public benefit commitments, public benefits associations, foundations and public benefits foundations to private individuals as stipulated in their founding documents, non-monetary benefits (excluding non-wage benefits as defined by the Act) allocated to individual entities by interest groups of employees, monthly monetary benefits not exceeding 50% of the prevailing minimum wage and professional awards and prizes established after 1 January 2008 and awarded after public nominations to private individuals for their outstanding work and exceptional achievements in Hungarian culture, science, art, and sports and then made publicly accessible.

The income is taxable if it is allocated to founders or donors or any private individuals employed or standing in

another legal relationship aimed at employment, irrespective of their title.

Particular benefits of some associations and foundations (public benefit foundations) are not taxable and are as follows: representation if provided by them, total value of business gifts whose value per item amounts to 25% of the minimal wage. In some associations and foundations (public benefit foundations) particular benefits mean representation if provided by them and business gifts whose value per item amounts to 25% of the minimal wage. Their total value is tax free. Organisations not performing entrepreneurial activities do not pay taxes if 10% of their expenses on public benefit or targeted activities shown in the report of the tax year does not exceed 10% of their total annual income.

The operational costs of organisations and bodies of civil service organisations include administrative costs, other incurred direct costs and a depreciation description of immaterial assets and tangible assets used for several activities. Under the Act on Public Interest Voluntary

Activities, in cases where the value of voluntary work per hour is calculated, one hundred and sixtieth of the current amount of the compulsory minimum wage shall be taken into account. The wages and salaries of voluntary workers are shown as income and their benefits are shown as staff costs.

CONCLUSIONS

If a civil society organisation is established as another type of organisation and not as a non-profit organisation, special attention should be paid to the fact that this sector lacks a single legal background. However, there are several laws stipulating both the operation and accounting duties of such organisations. Excellent knowledge of legislation is mandatory not only to manage accounting of economic events but also to properly perform everyday activities.

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