# Capitalization of tangible and intangible assets in non-profit organizations in Bulgaria

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## CAPITALIZATION OF TANGIBLE AND INTANGIBLE ASSETS IN NON-PROFIT ORGANIZATIONS IN BULGARIA

**Abstract.** *The report analyzes applicability of the equity capital approach for the acquisition of tangible and intangible assets by non-profit organizations in Bulgaria. Attention is also paid to the accounting of depreciation of the assets. Without any claims of comprehensiveness, the conclusions in the report are based on analysis of accounting and legal literature, Bulgarian national accounting standards, as well as data collected from individual interviews that the author conducted among accountants.*
**Key words:** *non-profit organizations, depreciation, long-lasting assets, capitalization.*

## INTRODUCTION

Non-profit organizations (NPO) are in general voluntarily formed unions that are created to meet public needs and to help identify and address issues of social significance. In Bulgaria the accounting regulations of such organizations are introduced only at the texts of national accounting standard №9 (NAS 9) "Presentation of financial statements of non-profit organizations". Currently there is no international accounting standard, regarding non-profit organizations, endorsed by the International Accounting Standards Board. As a reason it can be pointed out that legislative and financial control of society is let to be a subject to the political will and the existing attitudes in every member state of the European Union. The last changes of the Bulgarian law for non-profit organizations are made at the beginning of 2018. No changes are introduces at the texts of NAS 9, which is a prerequisite for different accounting practices in accounting the assets, liabilities, revenues and expenses of the organizations in the sector. It should be noted that the resources of non-profit entities must be spent in accordance to their ideal objectives which are set out in the statutes or the constitutive act. This as well as the possibility NPOs to conduct business activities directly affect the accountability of long-lasting assets, so the existence of different accounting practices is inappropriate.

A main goal of the paper is to analyze the applicability of the equity capital approach[14] for accounting the acquisition of tangible and intangible assets. The hypothesis advocated by the author is that the use of the approach is appropriate in terms of accounting the specific activities of such kind of organizations, but it is impracticable in practice because of the legal requirements and procedures, arising from the change of the capital. A main object of analysis are long-lasting tangible and intangible assets of non-profit entities in Bulgaria. A subject of analysis are applicable accounting and legal literature, Bulgarian national accounting standards, as well as data collected from individual interviews that the author conducted among accountants.

**USE OF THE EQUITY CAPITAL APPROACH FOR ACQUISITION OF TANGIBLE AND INTANGIBLE ASSETS**

In accounting practices the most common ways to acquire tangible and intangible assets by NPOs are through donation, as a subsequent property contribution from a founder of the organization and on the basis of inventory surpluses. Accounting entries reflecting the previously mentioned ways of acquisition do not differ materially from their accounting in business enterprises. However, it is essential for non-profit organizations that the property contributions of the founders (initial and subsequent) should be accounted as capital of the organization [4, art.3.3]. Damyanov, Pancheva and Atanasov support the thesis that long-lasting assets, which are not property contributions and will be used only for the purposes of the non-profit activities of the organization, and are acquired after the date of establishment of the non-profit entity, should also be accounted as an increase of the equity capital [1, p. 75-76; 2]. This requires introduction of additional accounting entry through which increases the capital and lowers the other reserves (such as: Debit 119 "Other reserves" and Credit 105 "Capital of non-profit organizations" [1, p.75]). The foregoing does not apply to assets that are acquired after the date of establishment of the non-profit organization, which are not property contributions and will be used

[14] By equity capital approach the author refers to an increase of the equity of the non-profit organization with the amount of the acquired tangible and intangible assets.

only for business activities of the organization. The idea of using the equity capital approach when an NPO is acquiring tangible and intangible assets can be supported with the following arguments:

1. The specific nature of the activities of non-profit organizations require their property to be spent directly and solely for the purposes set out in the statutes or the constitutive act. Because of that the economic benefits from the activities of the NPO are not in a relation to distribution of profits and property, but to a pursuit of the "ideal" goals of the organization.

2. Because of the lack of funds, non-profit organizations primarily rely on grants and donations. The selection criteria when applying for project funding from national and European funds and framework programs, are based on the financial security and economic stability of the applicant. The foregoing can be proved mostly by evidences for money and capital provision.

3. In a case when the tangible and intangible assets of the non-profit organization are not "preserved", this may lead to their rapid liquidity [7, p.203]. The fast consumptions of these resources is appropriate mainly for relatively large and economically active non-profit entities.

The use of the equity capital approach for acquisition of tangible and intangible assets by non-profit organizations, raises the question of properly accounting the depreciation of these resources.

**ACCOUNTING OF DEPRECIATION IN NON-PROFIT ORGANIZATIONS**

Accounting of the depreciation in non-profit organizations in Bulgaria must be done in accordance to the applied national accounting standards [4, art.3.6]. However, some specialists claim that depreciation must be accounted only for tangible and intangible assets used solely for the business activities of the NPO [2, p.28; 1, p.77; 3, p.125]. A main argument for such an opinion is that the positive results of non-profit activities of NPOs are not taxied with corporative taxes. In addition the results of the non-profit activities do not contribute to the reimbursement of the depreciation expenditures. In this respect the range of assets for which depreciation should be accounted must exclude those used for non-profit activities. Pancheva [5, p. 68] advocates that for depreciable assets used for the purposes of both non-profit and business activities, depreciation should not be accounted.

To outline the accounting practices regarding the issues under discussion, individual interviews with Bulgarian accountants were conducted[15]. Critical analysis of the collected data regarding the accounting practice in the field, indicates neglection of the requirement that depreciation should not be accounted for assets used only for non-profit activities of the NPO. However, if depreciation is accounted for such assets, then the information on account 119 "Other reserves" will not fairly present the financial result of the non-profit activities, when using the equity capital approach for the initial recognition of the assets. It is so because account 119 "Other reserves" will be once debited with the full amount of the asset when it is acquired, for the purposes of increasing the capital and will be debited once again with the amount of the asset's depreciation at the end of the reporting period. In this respect we join the opinion of the specialists that depreciation should not be accounted on tangible and intangible assets, which are reported as an increase of the capital of the NPO and will be used only for its non-profit activities. It is appropriate and useful to have this circumstance disclosed in the accounting policy of the organization.

None of the interviewed accountants applies the capital approach for accounting the NPO's tangible and intangible assets. It is so because they consider it completely "unjustified" when it comes to administrative burdens while registering the capital increase in the Commercial Register. However it is more appropriate the property of a non-profit organization to be used rather than "canned" [6, p.20]. Almost 29 % of the respondents point out that long-lasting assets, acquired for the purposes of the non-profit activities of the organization, are reported off-balance sheet. Therefore they do not account depreciation for such assets. Around 35% of the interviewed claim that they report all long-lasting assets in a similar way as they

[15] The time period of the data collected by the interviews is from 15.05.2018 to 30.06.2018. The interviews were conducted on the basis of personal meetings or by phone calls. The percentage of respondents that participated in the study was 35% of total 40 respondents. The defined target group includes accountants with more than 5 years of experience, who individually are practicing the profession or are employed in an accounting firm and have nonprofit clients. As the main limitation of the survey, it can be stated that interviewees provide accounting services to non-profit organizations with low turnovers.

account them in a business enterprise. In this respect, regardless the purpose of use of the assets, they account depreciation for them. Around 26% indicate that most non-profit organizations to which they provide accounting services at, are “almost inactive". Because of that the acquisition of property, plant, equipment and intangible assets "is not commonplace". Interviewees share common opinion that essential for accountability is the correct and separate accounting of revenues and expenses from business and non-profit activities of NPOs. Illegal reporting of revenues and expenses from the business activities might "distort" the accounting and tax financial results of that activity. In this case it is a priority for the accountants to make distinguish between the business and the non-profit activities. The respondents think that "not reporting depreciation of the long-lasting assets will reflect to the formation of a higher positive financial result. This will not lead to an administrative sanction, when a check by the control authorities is made. It is so because the controllers mostly look for to find someone who do not properly account their revenues".

## CONCLUSIONS

As a conclusion, the main effects of the capitalization approach of tangible and intangible assets used by NPOs for non-profit purposes are as follow:

1. Based on the precautionary principle a measurement subsequent to initial recognition must be made to all long-lasting assets of the organization. In case that the asset is used solely for the purposes of the non-profit activities, it falls into the hypotheses of non-depreciable. If depreciation is not accounted it would result in false and incorrect presentation of the information in the financial statements of the organization. In this respect the use of the equity capital approach can lead to avoid a breach of the precautionary principle.

2. Property and financial capabilities of non-profits organizations are main criteria when awarding a grant. By increasing the capital with the value of the acquired tangible and intangible assets, the requirements for awarding a grant are more easily achieved and the organization's chances of receiving funding are increased.

3. The equity of the non-profit organization is also a factor influencing the image of the entity. Bigger capital is a factor for citizens to have trust towards the organization, hence the public attitudes towards donating and volunteering for the organization's causes are increasing.

4. Changes in the registered capital of non-profit entities should find a documentary justification in the statutes or constitutive act of the organization. In this respect, any change in the capital should be approved by a general meeting of the NPO's members and announced at the Commercial Register. The foregoing is related to expenditure of money and time resources, and frequent administrative and bureaucratic procedures.

5. The write-off of fixed asset should be carried out as a result of a marriage, by decision of the management body or in case of an established lack. In this case it is necessary an additional accounting entry for reduction of the capital to be made. The reduction in the amount of the capital should be approved by a general meeting of the NPO's members and announced at the Commercial Register.

Because of the two previously mentioned negative aspects and based on the analyzed data from the interviews, it can be suggested that at the accounting practices in Bulgaria regarding NPOs, the use of the capital approach is rare.

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