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The future of not-for-profit accounting standards

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Contacts

On April 10th, 2013, the Canadian Accounting Standards Board ("AcSB") and the Public Sector Accounting Board ("PSAB") released a Statement of Principles *Improvements to Not-for-Profit Standards (Applicable to Private and Public Sector Not-for-Profit Organizations that use the Not-for-Profit Standards as their primary source of GAAP)* (the "SOP"). Comments on the SOP are due by December 15th, 2013. Visit **www.frascanada.ca** to access the SOP.

The SOP represents the key principles that the AcSB and the PSAB expect to use as the basis for developing new accounting standards for not-for-profit organizations. The principles expressed in the SOP are substantially aligned for private sector and public sector Not-for-Profit Organizations (NFPO); however, there are some differences identified in the proposals due to differences in the private and public sector accounting frameworks and differences in the needs of users.

In developing the SOP, both Boards carefully considered the conceptual framework underpinning their respective frameworks and critically challenged the existing accounting principles, some of which were considered to be inconsistent with the conceptual framework. For example – restricted contributions should be recorded as deferred contributions only as long as they meet the conceptual definition of a liability.

The SOP is the first step in the process to amend the NFPO accounting standards and it is a preliminary document in advance of the issuance of formal exposure drafts issued by the AcSB and the PSAB. The Boards are seeking input at this stage and the results of the input will be critical to the content of the future exposure drafts of proposed accounting changes.

The principles fall into the following categories:

- Contributions
- Tangible capital assets
- Intangible assets
- Tangible and intangible capital assets ("size exemption")
- Controlled and related entities
- Financial statement presentation
- Works of art, historical treasures and similar items

What is a not-for-profit organization?

A not-for-profit organization is an entity, normally without transferable ownership interests, organized and operated exclusively for social, educational, professional, religious, health, charitable or any other not-for-profit purpose.

What is a public sector organization?

Public sector organizations include federal, provincial, territorial, local governments, government organizations, government partnerships and school boards that are controlled by the government.

Where do not-for-profit organizations look for their reporting standards?

- **Private Sector NFPO**
  Accounting Standards for Not-for-Profit Organizations (Part III of the CICA Handbook) and Accounting Standards for Private Enterprises (Part II of the CICA Handbook) to the extent topics are not addressed in Part III.

- **Public Sector NFPO**
  Public Sector Accounting (PSA Handbook) either with or without the Public Sector (PS) 4200 series.

It's important to remember that the principles are proposing changes to Part III of the CICA Handbook and the PS 4200 series. The principles do not propose any direct changes to the PSA Handbook. As such, it would seem that the principles will not directly affect a public sector not-for-profit organization that does not follow the 4200 series. Some of the principles are not proposing changes at all but simply reinforcing the fact that the AcSB and PSAB Boards believe that no changes should be made and that the current guidance should remain in place. Whether a particular principle would represent a change to your organization depends on your starting place and whether you are a public or a private sector not-for-profit organization.

The principles outlined in each of the various sections below have been reproduced directly from the SOP.

"The Statement of Principles contains 15 proposed principles. They will be of varying interest to NFPO, depending on the nature of the organization, its particular circumstances and whether it is in the Private or Public Sector.

Contributions

Contributions Principle 1

An NFPO should recognize a contribution as an asset (a receivable) when it has control of the contribution, when it would exercise that control if necessary, and when it can reasonably estimate the amount to be received.

Contributions Principle 2

An NFPO should recognize a contribution as revenue when the contribution is received or receivable in accordance with Principle 1, except when, and to the extent, the contribution gives rise to an obligation that meets the definition of a liability.

Contributions Principle 3

When a contribution's stipulations have given rise to an obligation that meets the definition of a liability, an equivalent amount of revenue should be recognized as the liability is settled. Revenue recognition should occur in a manner consistent with the circumstances and the evidence used to support the initial recognition of the liability.

Contributions Principle 4

An NFPO may choose to recognize contributions of materials and services at fair value when a fair value can be reasonably estimated.

Key points

- A single method of accounting for contributions for all not-for-profit organizations
- Recognition of contributions based on the organization being able to control its access to the benefit
- Contributions are to be recorded as revenue for all not-for-profit organizations when the organization can control access to the benefit
- Contributions that contain restrictions are to be deferred only when the restriction gives rise to an obligation that meets the accounting concepts definition of a liability
- No changes to the current choice of whether to record contributed materials and services, when certain conditions are met

	Considerations for private sector not-for-profit organizations	Considerations for public sector not-for-profit organizations
Single method of accounting for contributions	Under the proposed principles, there would no longer be an accounting policy choice between the restricted fund and deferral methods of accounting for contributions. The new, single method of accounting will likely have some similarities with the deferral method, but with some very important differences, as highlighted further below. Presumably organizations wanting to follow fund accounting in their financial statements would still be able to do so. **The bottom line:** Less flexibility in how organizations account for contributions and present their financial statements, but more consistency.	
Control over access to the benefit	Pledges are unlikely to meet the recognition criteria before the cash is received. Control implies that the receipt of the contribution must be legally enforceable, which may not be the case with most pledges. The recognition of other contributions receivable may also need to be reconsidered. **The bottom line:** This could result in later revenue recognition for certain contributions receivable, which depending on circumstances could be similar to a cash basis of accounting.	
Contributions to be recorded as revenue	Organizations that follow the deferral method of accounting would no longer be able to record certain kinds of contributions, such as permanently restricted endowment contributions, as direct increases in net assets. Instead, they would be recorded as revenue once the recognition criteria are met, generally expected to be on receipt. **The bottom line:** No more contributions recorded as direct increases in net assets which will result in income statement volatility if an organization was previously following the deferral method of accounting.	
Deferral of restricted contributions only when the definition of a liability is met	Some restricted contributions that are deferred today would not be eligible for deferral under the proposed principles. The proposed changes are consistent with the government transfer standard in *Section PS 3410 Government Transfers*. An example is restricted contributions related to the purchase of capital assets. The SOP seems to suggest that the obligation is satisfied when the organization purchases the funded asset. As a result, recognition of contribution revenue could be expected to occur on acquisition of the asset, not over its useful life as it is today. This will introduce significant volatility into the financial results of many NFPO. Other restricted contributions that are deferred under existing standards would need to be reconsidered to determine if deferral remains appropriate. Organizations following the restricted fund method of accounting may also have to change the timing of recognition of restricted contributions as revenue. Under the proposed principles, even when restricted contributions are reported in a fund, consideration still needs to be given as to whether the restrictions create obligations that meet the definition of a liability. If the definition is met, the restricted contribution would be deferred until the obligation is satisfied, even if the contribution is reported in a restricted fund. **The bottom line:** Organizations following the deferral method of accounting for contributions may end up recognizing some restricted contribution revenue sooner; those following the restricted fund method of accounting may end up recording some restricted contribution revenue later.	
Recording contributed materials and services	The SOP proposes to maintain the choice for recording contributed materials and services, subject to certain conditions. The Boards are proposing to maintain this choice recognizing that there are practical issues with recording contributed materials and services. As an example, consider an organization that relies heavily on the use of volunteers and the challenges with recording those contributed services. **The bottom line:** No changes expected.	

Tangible and intangible capital assets

Tangible Capital Assets Principle 5
An NFPO applying Part III should apply PROPERTY, PLANT AND EQUIPMENT, Section 3061 and DISPOSAL OF LONG-LIVED ASSETS AND DISCONTINUED OPERATIONS, Section 3475 in Part II, in reporting the capitalization, amortization and disposal of tangible capital assets. TANGIBLE CAPITAL ASSETS HELD BY NFPOs, Section 4431 in Part III, would be amended to include write-downs to reflect a partial loss of service potential of an asset that is still being used.

An NFPO applying the CICA PSA Handbook, including the 4200 series, should apply TANGIBLE CAPITAL ASSETS, Section PS 3150, in reporting the capitalization, amortization, write-down and disposal of tangible capital assets.

Intangible Assets Principle 6
An NFPO applying Part III of the CICA Handbook – Accounting should continue to apply INTANGIBLE ASSETS HELD BY NFPOs, Section 4432. This Section would be amended to include write-downs to reflect a partial loss of service potential of an asset that is still being used.

An NFPO in the public sector applying the CICA PSA Handbook including the PS 4200 series should continue to apply CAPITAL ASSETS HELD BY NFPOs, Section PS 4230, in accounting for intangible properties.

Tangible and Intangible Capital Assets ("Size Exemption") Principle 7
Regardless of its size, an NFPO should recognize its capital assets in accordance with Principles 5 and 6. There should be no arbitrarily imposed criteria or limit that permits non-recognition of capital assets.

Key points

- Guidance on accounting for tangible and intangible capital assets will be streamlined with redundant guidance removed
- Guidance to be added for partial write downs
- The size exemption for smaller not-for-profit organizations allowing them to avoid capitalization of capital assets is to be removed
- Materiality guidance still applicable

	Considerations for private sector not-for-profit organizations	Considerations for public sector not-for-profit organizations
Removal of capital asset guidance	Organizations will be directed to accounting standards for private enterprises in Part II to account for tangible and intangible capital assets including the assets held for sale guidance. **The bottom line:** There may not be much difference in practice since the Part III guidance related to capital assets was developed based on similar guidance for profit-oriented enterprises.	The 4200 series guidance on accounting for tangible capital assets will be removed and all public sector organizations will follow the guidance in *Section PS 3150 Tangible capital assets*. **The bottom line:** Not expected to result in significant changes but should result in greater consistency and comparability with all public sector organizations following the same guidance.
Write downs of capital assets	Guidance to be added to Part III *Section 4431 Tangible capital assets held by not-for-profit organizations*, to allow for partial write downs of tangible and intangible capital assets. **The bottom line:** Added complexity and judgment may result when organizations need to consider the existence and amount of write downs in situations other than complete loss of long-term service potential.	It is being proposed that that the reporting requirements regarding the capitalization, amortization, write-down and disposal of tangible capital assets in *Section PS 4230 Capital assets held by not-for-profit organizations* be withdrawn. As such, organizations would follow the guidance in *Section PS 3150 Tangible capital assets* including the write-down provisions which allow for partial write downs. **The bottom line:** Added complexity and judgment may result when organizations need to consider the existence and amount of write downs in situations other than complete loss of long term service potential.
Recording intangible assets	The SOP is not proposing any changes to recording intangible assets. Organizations would continue to follow the guidance in Part III *Section 4432 Intangible assets held by not-for-profit organizations*, which includes the application of the guidance in Part II *Section 3064 Goodwill and Intangible Assets*. **The bottom line:** No changes expected.	The PSA Handbook does not permit the recording of intangibles. However some organizations following *Section 4230 Capital assets held by not-for-profit organizations* are permitted to record intangible assets, in limited circumstances. Those organizations following the PSA Handbook with the 4200 series will continue to recognize intangible assets. PSAB is requesting respondents to comment on whether a standard on intangible assets is needed. **The bottom line:** No changes expected at this time.
Removal of size exemption	The exemption allowing smaller not-for-profit organizations, with annual revenues of less than $500,000, to expense capital assets on acquisition rather than capitalizing them, would be removed. **The bottom line:** Added record keeping for smaller organizations that availed themselves of the size exemption. Improved comparability and consistency between organizations.	

Controlled and related entities

Controlled and Related Entities Principle 10
An NFPO applying Part III of the CICA Handbook – Accounting should:

(a) consolidate controlled NFPOs, subject to an exclusion from consolidation of a large number of individually immaterial organizations; and
(b) account for controlled profit oriented enterprises in accordance with the equity method.[1]

NFPOs in the public sector should apply GOVERNMENT REPORTING ENTITY, Section PS 1300, PORTFOLIO INVESTMENTS, Section PS 3041, GOVERNMENT PARTNERSHIPS, Section PS 3060, INVESTMENTS IN GOVERNMENT BUSINESS ENTERPRISES, Section PS 3070, and FINANCIAL INSTRUMENTS, Section PS 3450 in the CICA PSA Handbook to account for their controlled and related entities.

Controlled and Related Entities Principle 11
An NFPO applying Part III of the CICA Handbook – Accounting should continue to disclose an economic interest in another NFPO over which it does not have control in accordance with REPORTING CONTROLLED AND RELATED ENTITIES BY NFPOs, Section 4450.

An NFPO applying the CICA PSA Handbook including the PS 4200 series should continue to disclose an economic interest in another NFPO over which it does not have control in accordance with REPORTING CONTROLLED AND RELATED ENTITIES BY NFPOs, Section PS 4250.

Controlled and Related Entities Principle 12
An NFPO applying Part III of the CICA Handbook – Accounting should continue to apply DISCLOSURE OF RELATED PARTY TRANSACTIONS BY NFPOs, Section 4460.

An NFPO applying the CICA PSA Handbook including the PS 4200 series should continue to apply DISCLOSURE OF RELATED PARTY TRANSACTIONS BY NFPOs, Section PS 4260, pending completion of PSAB's Related Party Transactions project.

Key points

- Accounting guidance for controlled entities to be clarified with some policy choices eliminated
- No changes to economic interests disclosure requirements
- Minor changes to related party disclosure requirements

[1] The equity method proposed would not require that the accounting principles of the subsidiary be conformed with those of the parent.

	Considerations for private sector not-for-profit organizations	Considerations for public sector not-for-profit organizations
Accounting for controlled entities	The SOP proposes that organizations would consolidate controlled not-for-profit organizations; a large number of individually immaterial organizations will still be exempt from consolidation, as under current standards. Organizations would account for controlled profit oriented enterprises using the equity method. **The bottom line:** Some of the accounting choices in this area are proposed to be eliminated. Organizations with related entities will need to assess the existence of control, with a view to consolidating any not-for-profit organizations that are controlled (and equity accounting for profit oriented investees). Many organizations currently only provide disclosure for controlled organizations, as allowed by current standards. These proposals may represent a significant change to accounting policies for some organizations.	The guidance on accounting for controlled entities as found in *Section PS 4250 Reporting controlled and related entities by not-for-profit organizations* would be removed. There are no accounting policy choices under PSAB for determining whether to consolidate, and there is no exemption for individually immaterial organizations. Organizations will have to classify their controlled and related entities into the classifications available in *Section PS 1300 Government reporting entity*, and follow the appropriate standard, which could result in consolidation, modified equity accounting, or proportionate consolidation. **The bottom line:** This may be a significant change for organizations that have controlled and related entities as the accounting policy choices will be eliminated. Organizations will need to classify their controlled and related entities in accordance with *Section PS 1300 Government reporting entity* and determine the appropriate accounting treatment based on its classification.
Disclosure of economic interests	The SOP proposes that current standards in this area be preserved. **The bottom line:** Little or no changes expected.	The SOP proposes that current standards in this area be preserved. The PSA Handbook with the 4200 series requires disclosure of economic interests and such disclosures are not required without the 4200 series. **The bottom line:** Little or no changes expected.
Disclosure of related parties	The SOP proposes the Part II guidance in *Section 3840 Related Party Transactions* would be referred to with the exception of measurement provisions. **The bottom line:** Little or no changes expected.	The SOP proposes no changes in this area. The PSA Handbook would continue to be silent in terms of related party disclosures and the 4200 series guidance in *Section PS 4260 Disclosure of related party transactions by not-for-profit organizations* will be retained. **The bottom line:** Little or no changes expected until such time that PSAB finalizes its related party transactions project.

Financial statement presentation

Financial Statement Presentation Principle 13
A private sector NFPO applying Part III of the CICA Handbook – Accounting should apply INCOME STATEMENT, Section 1520, BALANCE SHEET, Section 1521, CASH FLOW STATEMENT, Section 1540, and other appropriate Sections in Part II in presenting their financial statements.

A public sector NFPO should apply Financial Statement Presentation, Section PS 1201, and other appropriate Sections of the CICA PSA Handbook in presenting their financial statements.

Both Boards propose to retain certain of the guidance material in the existing not-for-profit standards that address unique financial statement presentation issues faced by NFPOs. The Boards do not intend to be any more prescriptive regarding the format of presentation or line items to be presented in the financial statements of an NFPO than the reference standards for each sector.

Financial Statement Presentation Principle 14
A private sector NFPO with more than one function should present its expenses by function in its financial statements and disclose its expenses by object (nature) in the notes to the financial statements.

A public sector NFPO would apply FINANCIAL STATEMENT PRESENTATION, paragraph PS 1201.088 in the CICA PSA Handbook.

An NFPO should present total fundraising expenses and general support expenses as separate functions in the statement of operations or disclose them in the notes to the financial statements.

Financial Statement Presentation Principle 15
An NFPO applying Part III of the CICA Handbook – Accounting should continue to apply DISCLOSURE OF ALLOCATED EXPENSES BY NFPOs, Section 4470.

An NFPO applying the CICA PSA Handbook including the PS 4200 series should apply DISCLOSURE OF ALLOCATED EXPENSES BY NFPOs, Section PS 4270.

Key points

- General financial statement presentation standards to be clarified
- Presentation of expenses by function on the face of the statements and disclosure of expenses by object (nature)
- Required disclosure of fundraising and general support expenses
- No changes to allocated expenses disclosure requirements

	Considerations for private sector not-for-profit organizations	Considerations for public sector not-for-profit organizations
General financial statement presentation standards	The SOP proposes that organizations should follow the general financial statement presentation standards for private enterprises found in Part II. Some supplementation to deal with matters specific to NFPO is proposed to be retained. **The bottom line:** Little change is expected here; however, organizations should consider the proposals in light of their particular financial statements.	The SOP proposes that organizations should refer to the reference standard *Section PS 1201 Financial statement presentation* for financial statement presentation. **The bottom line:** Significant changes to financial statement presentation including a new statement of net debt.
Presentation of expenses by function	The SOP proposes that expenses be presented by function on the face of the statements and expenses by object (nature) would be disclosed in the notes. Examples of functions include: administration, fundraising and programs. Examples of object/nature include: salaries, advertising, maintenance and amortization. **The bottom line:** Better information for statement users to assess accountability and stewardship as well as enhanced comparability between organizations. Additional work may be required for financial statement preparers to track expenses by function.	
Presentation of fundraising and general support expenses	The SOP proposes that the aggregate amounts of fundraising and general support expenses would be disclosed either in the statement of operations or in the notes. **The bottom line:** Better information for users of the financial statements and potentially additional work for preparers.	
Disclosure of allocated expenses	The SOP proposes that current standards in this area be preserved. **The bottom line:** Little or no changes expected.	

Works of art and historical treasures

Works of Art, Historical Treasures and Similar Items Principle 8
An NFPO applying Part III of the CICA Handbook – Accounting should continue to apply COLLECTIONS HELD BY NFPOs, Section 4440, in reporting its collections and should recognize its collections at either cost or nominal value in the statement of financial position.

An NFPO in the public sector applying the CICA PSA Handbook including the PS 4200 series should continue to apply COLLECTIONS HELD BY NFPOs, Section PS 4240, in reporting its collections.

Works of Art, Historical Treasures and Similar Items Principle 9
An NFPO applying Part III of the CICA Handbook – Accounting should continue to account for works of art, historical treasures and similar items being held as capital assets that are not part of a collection by applying TANGIBLE CAPITAL ASSETS HELD BY NFPOs, Section 4431. Assets acquired with the intention of selling them would continue to be accounted for in accordance with INVENTORIES HELD BY NFPOs, Section 3032.

An NFPO in the public sector applying the CICA PSA Handbook including the PS 4200 series should continue to account for works of art, historical treasures and similar items being held as capital assets that are not part of a collection by applying CAPITAL ASSETS HELD BY NFPOs, Section PS 4230.

Key points

- Guidance for measurement of collections
- No changes to whether or not works of art, historical treasures and similar items part of a collection are recorded
- No changes to works of art, historical treasures and similar items not part of a collection

	Considerations for private sector not-for-profit organizations	Considerations for public sector not-for-profit organizations
Measurement of collections	The SOP proposes explicit measurement guidance for collections. If recorded, they would be measured at cost or nominal value. **The bottom line:** Clarified guidance for measurement may change current practice and should result in consistency and greater comparability between organizations.	The SOP is not proposing guidance for the measurement of collections. **The bottom line:** No changes expected.
Recording works of art, historical treasures and similar items part of a collection	The SOP proposes to maintain the choice whereby organizations have the option to record collections but are not required to do so. **The bottom line:** No changes expected.	The SOP proposes to maintain that organizations following the PSA Handbook with the 4200 series will still have a choice as to whether or not they record collections. Organizations following the PSA Handbook without the 4200 series will still be precluded from recording collections. **The bottom line:** No changes expected.
Recording works of art, historical treasures and similar items not part of a collection	The SOP proposes that current standards in this area be preserved. **The bottom line:** No changes expected.	The SOP proposes that current standards in this area be preserved. Organizations following the PSA Handbook with the 4200 series will continue to capitalize in accordance with intended use. Organizations following the PSA Handbook without the 4200 series will still be precluded from recognizing such items. **The bottom line:** No changes expected.

We highly encourage you to respond to the SOP so you can influence and impact the future of the not-for-profit accounting standards. As a reminder, comments on the SOP are due to the AcSB and PSAB no later than December 15, 2013.

If you have any questions or matters that you would like to discuss, please do not hesitate to get in touch with your Deloitte contact or any of the individuals listed below.

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