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Managing the transition

A new accounting framework for government Not-for-Profit Organizations

Contents

Introduction

The accounting framework followed by government Not-for-Profit Organizations (GNFPOs) is in transition. In September 2010, the Public Sector Accounting (PSA) Standards Board approved the following:

1. GNFPOs **must** adopt PSA Standards as its new underlying accounting framework, and
2. GNFPOs have a **choice** to continue to apply eight Handbook sections (PS 4200 to 4270) which incorporate the current Not-for-Profit accounting standards (CICA 4400 to 4470 – the "4400 series of standards") into the PSA Handbook.

GNFPOs will be required to adopt the standards for fiscal periods beginning on or after January 1, 2012. Throughout this publication, we will refer to the overall transition as adopting PSA Standards and the two choices as (b) PSA + NPO – for those organizations that choose to continue to apply the specific Not-for-Profit standards, and (a) PSA Only – for those organizations that choose not to apply the specific Not-for-Profit standards.

Adopting PSA Standards as a new underlying accounting framework will involve making more than just accounting standard changes. Most organizations will also need to consider whether information system changes are necessary, provide training for staff, communicate with stakeholders, coordinate their activities with government and review contractual and other agreements. Organizations need to design and implement a comprehensive transition plan that addresses all of the financial, operational, legal and other considerations associated with the change in their accounting framework.

This publication describes some of the issues for a GNFPO to address when planning the transition, including:

- Confirming that the government organization is a GNFPO
- Reporting and operational considerations associated with adopting PSA Standards
- An overview of the differences between current Canadian GAAP and PSA Standards that will be applicable to GNFPOs
- A roadmap for converting from current Canadian GAAP to PSA Standards
- Conversion issues for audit committees to consider

Government Not-for-Profit Organizations (GNFPO)

Government organizations – i.e., organizations controlled by a government – fall within the scope of the PSA Standards Handbook. The Introduction to the PSA Standards currently requires that GNFPOs follow the CICA Handbook - Accounting, also referred to as current Canadian GAAP or "the Blue Book" for Not-for-Profit Organizations.

The definition of a GNFPO is not changing in the new accounting framework. The criteria that a government controlled organization must meet to be classified as a GNFPO are below:

Criteria	Current Introduction to PSA Standards	Revised Introduction to PSA Standards
Entity is normally without transferable ownership interests	✓	✓
Entity is organized and operated exclusively for social, educational, professional, religious, health, charitable or any other Not-for-Profit purpose	✓	✓
The entity's members, contributors and other resource providers do not, in such capacity, receive any financial return directly from the organization	✓	✓
The entity has counterparts outside of the public sector	✓	✓

While the criteria are not changing, in the course of discussions on the changing accounting framework, the last criteria listed "The entity has counterparts outside of the public sector" has been the subject of significant attention and discussion. There is no interpretive guidance provided in the PSA Handbook on this criterion, and therefore, the interpretation is subject to significant judgment. If a government controlled organization does not meet all of the criteria to be classified as a GNFPO, it would likely be classified as an other government organization (OGO), and subject to a different accounting framework. Therefore, confirming that the organization is a GNFPO is an important step in determining the appropriate accounting framework to follow.

A summary of the accounting framework for GNFPOs and OGOs and timing of adoption is described below:

Classification	New accounting framework
Government Not-for-Profit Organizations (GNFPOs)	GNFPOs must adopt PSA Standards as its new underlying financial accounting framework. GNFPOs have a choice to: • Continue to apply the eight Handbook sections (PS 4200 to 4270) which incorporate the current Not-for-Profit accounting standards into the PSA Handbook (PSA + NPO), or • Apply the CICA PSA Handbook alone without Sections PS 4200 to 4270 (PSA Only.) GNFPOs are required to adopt this new accounting framework for fiscal years beginning on or after January 1, 2012, retroactively with restatement of comparative figures. GNFPOs will likely find that adopting the PSA Standards will result in changes from their current accounting practices, which are based on current Canadian GAAP and the 4400 series of standards.
Other government organizations (OGOs)	OGOs are required to follow either PSA Standards or IFRSs for fiscal years beginning on or after January 1, 2011 (restated comparative figures are also to be provided). OGOs are to select their accounting framework based on an assessment of user needs and comparability with other relevant organizations.

Also of note is the standards for GNFPOs differ from those recently approved for Not-for-Profit Organizations (NPOs) that are not controlled by the government. Therefore, it is also important to confirm that the organization is controlled by the government. The differences in the accounting frameworks for GNFPOs as compared to non-government controlled NPOs are as follows:

Accounting framework alternatives	GNFPOs	Non-government controlled NPOs
Adopt PSA Standards, including guidance from current 4400 series of standards on Not-for-Profit Organizations (PSA + NPO)	✓	✗
Adopt PSA Standards, excluding guidance from current 4400 series of standards on Not-for-Profit Organizations (PSA Only)	✓	✗
Adopt Accounting Standards for Private Enterprises, including guidance from current 4400 series of standards on Not-for-Profit Organizations	✗	✓
Adopt International Financial Reporting Standards (IFRSs) (not supplemented by the 4400 series of standards)	✗	✓

Given the potentially significant differences that could result from application of a different accounting framework, organizations who currently classify themselves as GNFPOs are advised to confirm that they meet the criteria of a GNFPO.

Reporting and operational considerations

Moving to a new accounting framework involves more than just identifying and quantifying the required accounting standard changes. Adopting a new accounting framework may also create a variety of reporting and operational issues that will need to be addressed. A summary of some of these challenges, and suggested strategies to mitigate them, is presented below.

	Challenge	Mitigating strategy
Relationships with government	The government has oversight responsibilities over all government entities. Financial statements prepared under different accounting frameworks may present a challenge to them in establishing budgetary requirements and performing their oversight activities.	Timely consultations with all relevant stakeholders will help ensure that all of the potential impacts associated with the choice of accounting framework are identified and addressed appropriately.
Financial indicators	Changing accounting frameworks may affect the organization's key financial indicators and accountability agreements.	The impacts on financial indicators and accountability agreements should be assessed regularly throughout the conversion process. In some instances, exemptions may be appropriate in transitioning to new accounting standards.
Technology and processes	GNFPOs are consolidated in the government's financial statements, which currently requires that differences between the accounting standards currently used ("Blue Book") and PSA Standards be identified and quantified for purposes of conforming to the government's accounting policies. Those differences are expected to be fewer or eliminated entirely subsequent to the conversion to PSA Standards.	Systems should be evaluated and adjusted as required to meet both external and government reporting requirements.
Legal	A change in the organization's accounting framework may affect certain contracts and, therefore, contracts will need to be examined to fully understand any accounting implications. In addition, future contracts will need to consider the proper accounting treatment under the new accounting framework.	Organizations should review and analyze the contractual underpinnings to their relationships to determine the appropriate accounting treatment for them. For example, third party debt agreements may need to be renegotiated if the debt covenants are not appropriate under the new accounting framework.
Human resources	Activities required to plan and carry out the conversion to the new accounting framework will place increased demands on finance and other personnel.	The additional demands placed on key personnel may be reduced when personnel are provided with appropriate training programs and a rigorous project management and a comprehensive scoping exercise are utilized to manage the transition activities.

Similarities and differences between current Canadian GAAP for GNFPOs and the proposed standards

GNFPOs will be required to apply the principles in the PSA Handbook as a financial accounting framework for fiscal years beginning on or after January 1, 2012. Only GNFPOs that choose to continue to apply the Not-for-Profit standards (PSA + NPO) will follow PS 4200 to 4270. These Sections cover the following areas:

PSA Handbook	Current Canadian GAAP	Standard	Changes to standard
PS 4200	**4400**	Financial statement presentation by Not-for-Profit Organizations	Changes generally relate to removing references to other sections in the Blue Book. Reference to interim financial statements removed as the PSA Handbook does not have a standard in this area.
PS 4210	**4410**	Contributions – Revenue recognition	None
PS 4220	**4420**	Contributions receivable	None
PS 4230	**4430**	Capital assets held by Not-for-Profit Organizations	Elimination of reference to accounting for asset retirement obligations (PSA Standards do not include an accounting standard on asset retirement obligations.)
PS 4240	**4440**	Collections held by Not-for-Profit Organizations	None
PS 4250	**4450**	Reporting controlled and related entities by Not-for-Profit Organizations	Controlled profit oriented enterprises would be accounted by consolidating the controlled organization or accounting for it using the modified equity method.
PS 4260	**4460**	Disclosure of related party transactions by Not-for-Profit Organizations	None
PS 4270	**4470**	Disclosure of allocated expenses by Not-for-Profit Organizations	None

As previously noted, GNFPOs will be required to apply the principles in the PSA Handbook as a financial accounting framework and will have a choice to continue to apply the eight Not-for-Profit handbook sections (PS 4200 to 4270). Because Not-for-Profit Organizations currently follow current Canadian GAAP or the "Blue Book", it is important to understand the differences between the "Blue Book" and PSA Standards for those areas not covered by the eight Not-for-Profit handbook sections. Some of the potentially significant differences include:

Topic	Current Canadian GAAP ("Blue Book")	PSA Standards
Financial instruments	Organizations are required to classify financial instruments into one of four categories. Investments are typically carried at fair value, with immediate recognition of any changes in fair value, either in the Statement of Operations or in the Statement of Net Assets.	PSAB is in the process of finalizing a new standard on financial instruments. The proposed standard requires that certain investments and all derivatives be carried at fair value. The proposed standard introduces a new statement – statement of remeasurement gains and losses. For financial instruments measured at fair value, unrealized gains and losses are reported in the statement of remeasurement. The expected effective date for the new standard (years beginning on or after April 1, 2012) aligns with the transition.
Retirement and post-employment benefits	Discount rate: The rate used to discount post-employment benefit obligations is determined by reference to market yields at the end of the reporting period on high-quality corporate bonds. Actuarial gains and losses are recognized either in net income using the "corridor" approach or immediately. Sick leave benefits that accumulate but do not vest are not required to be accrued.	Discount rate: The rate used is determined by applying a discount rate with reference either to its plan asset earnings or to its cost of borrowing. For defined benefit plans, a government organization amortizes actuarial gains and losses to the liability or asset and the related expense in a systematic and rational manner over the expected average remaining service life of the related employee group. Sick leave benefits that accumulate but do not vest are accrued unless they are not significant.
Leases	The classification of a lease as either operating or capital is based on an analysis of whether substantially all of the benefits and risks have been transferred from the lessor to the lessee. Sale-leaseback transactions generally result in the deferral of any gain resulting from the transaction.	The classification of a lease as either operating or capital is also based on an analysis of the transfer of benefits and risks, however, additional guidance is provided in assessing the impact of leasing an asset that provides an essential service. PSA Standards for sale-leaseback transactions utilize a components approach and there is a substantive difference in the recognition of gains depending on whether the leaseback constitutes leased tangible capital asset or an operating lease.

GNFPOs who choose not to apply the eight handbook sections (PS 4200 to 4270) – those who choose the PSA only alternative – will also have to consider differences in accounting between the guidance provided by these sections and PSA Standards. Some of the potentially significant differences include:

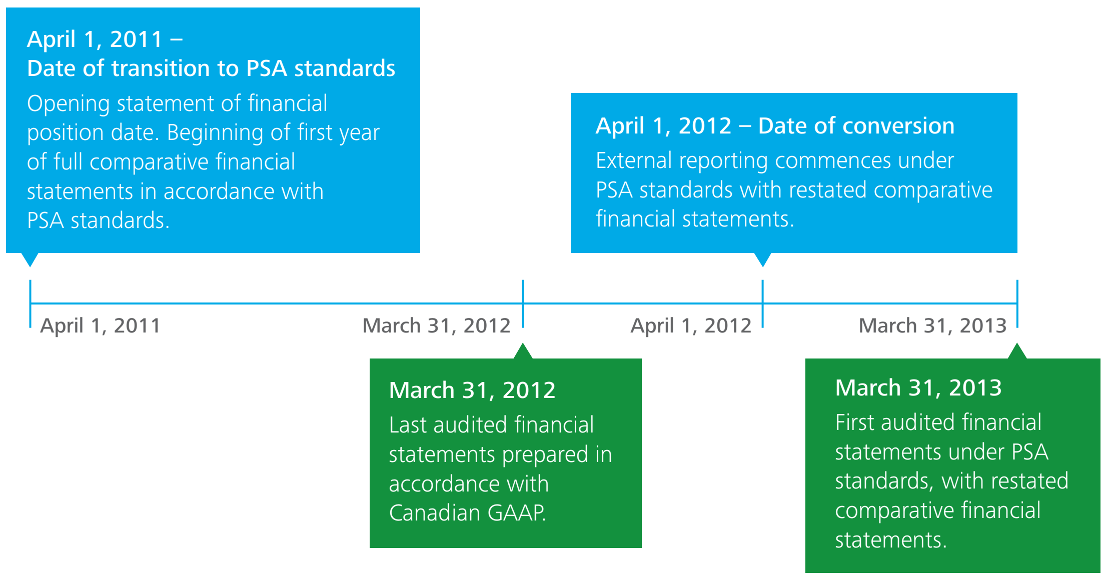
Topic	Not-for-Profit accounting standards	PSA Standards
Presentation of financial statements	Financial statements include: • Statement of financial position • Statement of operations • Statement of changes in net assets, and • Statement of cash flows With accompanying notes to the financial statements. Entities may report separate funds and within those funds use either the restricted fund method or the deferral method of recognizing contributions. Entities who do not report separate funds use the deferral method of recognizing contributions.	Financial statements include: • Statement of financial position • Statement of operations (either by function or by program) • Statement of change in net debt, and • Statement of cash flows With accompanying notes to the financial statements. As noted in the section above on financial instruments, PSAB has recently released an exposure draft that, if approved, will require an additional statement – statement of remeasurement gains and losses. In addition to the comparative figures, budgeted amounts as originally approved and adjusted to conform to PSA Standards must be presented on the statement of operations and the statement of change in net debt.
Tangible capital assets and intangible assets	Entities may record intangible assets (such as patents, licenses, etc.) at cost. These assets are generally amortized over their useful lives, with amortization expense recorded in the statement of operations.	Intangible assets (other than software), works of art and historical treasures are not recognized in the financial statements.
Revenue recognition	Entities follow either the deferral method or the restricted fund method of recognizing contributions. Both methods provide detailed guidance on timing of recognition. Under the deferral method, contributions restricted for expenses related to a future period or the purchase of capital assets are deferred until the expenses are incurred or the capital asset is amortized.	PSA Standards provide guidance on accounting for both restricted revenues and government transfers. The timing of recognition is dependent upon the criteria and/or restrictions in the funding agreement. PSAB is in the process of finalizing a new standard on government transfers.

Transition to PSA Standards

In August 2010, a new PSA Standard was issued, PS 2125 – First time adoption by government organizations, which provides guidance for organizations transitioning to PSA Standards from another accounting framework. Some of the key provisions of that standard are:

Issue	Guidance
Transition	Retroactive application with restatement of prior periods, subject to the exemptions provided.
Exemptions	The guidance provides specific optional exemptions to retroactively restating prior periods in the following areas: a. Retirement and post-employment benefits b. Business combinations c. Investments in government business enterprises d. Government business partnerships e. Tangible capital asset impairment
Exceptions	The guidance prohibits retroactive application on: a. Some aspects of hedge accounting b. Accounting estimates
Disclosure	The guidance requires additional disclosure in the year of transition to enable the reader to understand the material adjustments made to the financial statements as a result of the transition to PSA Standards.

Timeline – First time adoption by GNFPOs with a March year end



Date of transition to Public Sector Accounting Standards
The beginning of the earliest period for which a government organization presents full comparative information in accordance with Public Sector Accounting Standards.

First Public Sector Accounting Standards financial statements
The first financial statements in which a government organization will follow the CICA Public Sector Accounting Handbook is for fiscal years beginning on or after January 1, 2012.

Government Not-for-Profit Organization (GNFPO)
A government organization that meets the definition of a Not-for-Profit Organization in the CICA Handbook – Accounting and that has counterparts outside the public sector. “Public sector” refers to federal, provincial, territorial and local governments, government organizations, government partnerships, and school boards.

Not-for-Profit Organizations
Defined in the CICA Handbook – Accounting as entities, normally without transferable ownership interests, organized and operated exclusively for social, educational, professional, religious, health, charitable or any other Not-for-Profit purpose. A Not-for-Profit Organization’s members, contributors and other resource providers do not, in such capacity, receive any financial return directly from the organization.

Opening statement of financial position
A government organization’s statement of financial position at the date of transition to Public Sector Accounting Standards.

Approach to transition

The transition to a new accounting framework is a complex process that must be managed efficiently. GNFPOs may wish to utilize the following three-phase approach to manage their conversion to a new accounting framework.

	Phase 1 – Planning	Phase 2 – Detailed diagnostic	Phase 3 – Implement
Objective	• Identify the high-level differences between PSA Standards and Canadian GAAP. • Develop a project plan and identify the required resourcing.	• Evaluate the financial impacts of various options and methodologies provided under PSA Standards. • Evaluate the financial impacts of various options under alternative methodologies.	• Build, implement and communicate the changes required to report PSA Standards compatible information.
Activities	• Identify the PSA Standards that are most significant to the government organization. • Identify the major differences between PSA Standards and Canadian GAAP. • Determine the impacts on financial reporting.	• Identify and design operational and financial processes. • Develop required solutions to address identified issues. • Perform a detailed analysis on the work streams identified in the project plan.	• Implement changes to operational and financial processes. • Develop internal communications to promote consistent understanding, education and resolution of critical issues. • Develop external communications to ensure that stakeholders and governments understand changes in financial reporting.
Outcomes and deliverables	• Develop a "heat map" that highlights, by standard and by financial statement line item, the financial impact and complexity of transitioning to PSA Standards.	• Develop position papers for each significant area that analyze the current accounting and conclude on the appropriate future accounting treatment.	• Facilitate a knowledge transfer within the organization. • Prepare financial statements in accordance with PSA Standards. • Implement ancillary changes (e.g. processes and controls) to meet the new accounting requirements.

Issues for audit committees to consider

GNFPO audit committees are actively involved in the oversight of their organization's accounting frameworks and financial reporting, and they should play an integral role in their organization's consideration of and transition to a new accounting framework. Some questions that audit committees may ask as part of their oversight of this process are presented below.

1. How has the organization decided on whether it will transition to PSA Only or PSA + NPO?
2. What are the most significant impacts on our financial statements?
3. What are the costs of the transition?
4. What are the ancillary impacts of the transition (i.e. accountability agreements, controls and processes, information technology, etc.)?
5. Have we vetted our positions externally?
6. Has management prepared a work plan to transition to PSA Standards?
7. Do we require training on PSA Standards?
8. What are our opportunities and risks in this project?
9. What is the impact on our reporting to other levels of government?
10. Do we have the internal expertise to carry out this work?

Conclusion

Deloitte serves numerous GNFPOs across Canada, including health care organizations, colleges, hospitals and a variety of other Not-for-Profit Organizations that are controlled by a level of government. As a multidisciplinary organization, our comprehensive range of services related to public sector accounting goes beyond just addressing the financial issues associated with adopting new accounting standards. Deloitte also provides assistance with project management, human resources and training, information systems development, stakeholder communications and more.

To discuss your organization's needs, the potential impacts on your financial reporting, and develop a comprehensive transition strategy, please contact one of our public sector accounting leaders.

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