

New Accounting Standards for Not-for-Profit Organizations - questions for directors to ask

Introduction

Accounting standards for all not-for-profit organizations in Canada will change for fiscal years beginning on or after January 1, 2012.

Directors will need answers to questions such as:

- **Which sets of accounting standards might apply to our organization? How do we choose between the available standards?**
- **What is the transition date? Does management have a plan in place to manage the transition?**
- **What are the implications of the change to our systems, staff, and stakeholders?**

Boards of directors and audit committee members in particular need to be aware of the upcoming change and its potential implications. Although it will be management's responsibility to execute the transition to the new standards, the board bears overall responsibility for the organization's financial reporting, and must provide oversight and ensure that management has discharged its responsibilities and executed an effective conversion.

In addition, when organizations need to make significant choices regarding accounting standards or policies, the board of directors (possibly through the audit or finance committee of the board) will generally be involved in the decision.

Background

Accounting standards in Canada for the private sector are set by the Accounting Standards Board (AcSB). Standards for the public (government) sector are set by the Public Sector Accounting Board (PSAB). There are not-for-profit organizations operating in both sectors, and they currently follow the same accounting framework, which includes a series of standards known as the 4400 series which address the unique circumstances of not-for-profit organizations.

Canada's accounting standards are in transition and the current framework is being replaced. Many profit-oriented enterprises adopted International Financial Reporting Standards (IFRSs) starting January 1, 2011. Those for-profit enterprises in the private sector which did not adopt the international standards are now applying newly-developed accounting principles for private enterprises. Accounting standards for not-for-profit organizations are changing as well.

The New Standards

It is expected that many private sector (ie. non-government) not-for-profit organizations will choose to adopt the new accounting standards specific to not-for-profit organizations. These will be largely similar to the current standards and will incorporate much of what is currently contained in the 4400 series (which addresses the unique circumstances of not-for-profit organizations). Private sector NPOs will also have the option of adopting International Financial Reporting Standards.

Government not-for-profit organizations will be required to use public sector accounting standards as the basis of their reporting. These may be supplemented by standards specific to not-for-profit organizations, the PS 4200 series, which are similar to the current 4400 series.

For some organizations, the impact of the changing standards will be minimal. For others, it will be more substantial. This director alert highlights some of the key changes taking place and presents questions that directors or audit committee members might ask to get a better understanding of the transition. Some questions are intended for directors to ask management, while others are questions for directors to discuss among themselves or with their accountants and/or auditors.

A. Differences between private sector and government NPOs

The first step for all organizations is to determine whether the organization is a private sector (or non-government) NPO or a government NPO (GNPO). The distinction will be significant in terms of the standards applicable and options available to the organization.

Not-for-profit organizations are 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.

A **government not-for-profit organization** is a government organization that meets the definition of a not-for-profit organization and that has counterparts outside the public sector. A government organization is an organization controlled by government. The determination of whether an organization is controlled by government is based on the facts and circumstances specific to the organization. The key is whether government has control of financial and operating policies of the organization. In many provinces this includes hospitals and colleges. Some universities and arts organizations are also controlled by a government.

For many organizations, there will be no doubt as to their status. However, there are some which have significant ties to government but may be unsure as to whether or not they are considered government-controlled NPOs. If management or the board of directors is in doubt about whether the organization is controlled by government or not, public sector accounting standards contain an extensive definition of control along with a list of indicators. Auditors or other external advisors may also provide guidance on the issue.

Questions for directors to ask:

1. **Has management made a determination as to whether or not our organization is a government-controlled NPO?**
2. **Do we understand the basis for and agree with that determination?**

B. Choice of Accounting Standards and Changes to be Expected

Once a decision has been reached as to the type of organization in question, the next step is to select among the available accounting standards.

Private Sector NPOs

Private or non-government NPOs have the following choices:

1. *Accounting Standards for Not-for-Profit Organizations* – Contained in Part III of the CICA handbook. These are based largely on the 4400 series which addresses the specific needs of not-for-profit organizations. A not-for-profit organization applying this Part of the Handbook also applies the standards for private enterprises in Part II of the Handbook to the extent that the Part II standards address topics not addressed in this Part. The vast majority of private sector NPOs will likely choose to adopt these standards. Most NPOs adopting these standards will not face major changes at the time of transition.

There are some differences between these standards and those currently in place relating to issues such as:

- Intangible assets
- Financial instruments
- Transaction costs
- Hedge accounting
- Defined benefit pension plans
- Valuation of capital assets

Statement presentation will differ somewhat in that the new standards require a cash flow statement as well as disclosure of all outstanding government remittances.

2. *International Financial Reporting Standards* – are the same standards which apply to public companies. These standards were developed for use by for-profit enterprises and do not contain any specific provisions to address the unique issues of NPOs. However, some organizations may consider the possibility of adopting IFRSs, such as organizations which are part of an international organization or have international stakeholders who are better served by the use of IFRSs.

The difference between IFRSs and the standards currently used by NPOs is significant. Two examples are:

- Revenue recognition – IFRSs has no provisions to address the unique nature of contribution revenues.
- Consolidation – IFRSs would require consolidation of all controlled entities and equity accounting for all entities in which the NPO has a significant influence.

Statement presentation would also differ:

- Fund accounting – IFRS does not address the presentation of separate funds in financial statements.
- Notes disclosure – is generally more detailed and extensive under IFRSs.

Government NPOs

All government NPOs will be required to use public sector accounting standards as the basis of their financial reporting, but have the following choices:

1. *Public Sector Accounting Standards* – the standards applicable to governments and other government organizations
2. *Public Sector Accounting Standards supplemented by 4200 series* – the standards applicable to governments and other government organizations with the addition of standards specific to NPOs similar to those currently contained in the 4400 series and those that will be included in the accounting standards for private NPOs. These not-for-profit specific standards have been renumbered as the 4200 series when they were brought into the Public Sector Accounting Handbook.

B. Choice of Accounting Standards and Changes to be Expected (continued)

All government NPOs will encounter some differences as they move to public sector standards, which will include new options as well as new reporting requirements. Differences in accounting will occur in areas such as:

- Hedge accounting
- Employee retirement benefits
- Other employee future benefits
- Intangibles
- Financial instruments

Statement presentation will not differ substantially for those organizations adopting the public sector handbook with the inclusion of the 4200 series. Organizations which chose not to adopt the 4200 series will have differences in the presentation of their financial statements but these financial statements will be more consistent with those of governments and other government organizations.

Questions for directors to ask:

1. **What factors did management consider when selecting the appropriate accounting standards for the organization?**
2. **Will the accounting framework selected provide useful information for the users of our financial statements?**
3. **How will our choice of accounting framework affect the comparability of our financial information with that of other organizations?**

C. Timing of the Transition

The first set of annual financial statements for NPOs with a December 31st year end will be for the year beginning January 1, 2012. However, these financials will need to include comparative information also compiled under the new standards for the year beginning January 1, 2011. In order to determine the results of operations and cash flows for 2011, management will also need to restate the organization's opening statement of financial position from the current standards to the new standards.

This date, January 1, 2011, is known as the "transition date" as this is the earliest date the organization is required to prepare information under the new standards. However, the current standards will continue to apply until the new ones are in place, so organizations will still be required to report under the current standards for 2011, unless specifically electing to adopt the new standards early, which is permitted. It is important to note that organizations with a different fiscal year end will have a different transition date.

There is specific guidance contained in the standards themselves regarding first time adoption to provide guidance on preparing the first set of financial statements under the new standards. A number of exceptions and exemptions are offered in order to make the process less onerous.

Questions for directors to ask:

1. **Has management considered whether early adoption of the new framework would be advantageous?**
2. **What is our organization's transition date?**
3. **Has management considered first time adoption elections?**
4. **Does management have a plan in place to manage the transition to the new standards?**
5. **What changes will be necessary to management information systems in order to generate the information required under the new standards?**
6. **What are the costs associated with the transition to new standards?**

D. Other Board Considerations

In addition to approving the selection of the accounting framework and overseeing management's plan for managing the transition, boards of directors should consider other issues stemming from the changing standards. These issues will vary by organization, but may include issues related to the board itself, its advisors or external stakeholders.

Questions for directors to ask:

1. **Is additional training or education necessary for staff? For the board or audit committee?**
2. **Have we discussed with our auditors the upcoming transition and their role in it?**
3. **Have we prepared our stakeholders for changes in the presentation and disclosure of our financial information?**
4. **How will changes in financial reporting affect other required reporting, for example to Canada Revenue Agency?**

E. Where to Find More Information

CICA Accounting Standards in Transition www.cica.ca/transition

Accounting Standards Board www.acsbcanada.org

Public Sector Accounting Board www.psab-ccsp.ca