Welch LLP

New Canadian Accounting Standards for Not-for-Profit Organizations (ASNFPO)

The accounting standards for not-for-profit organizations will change and this will create some opportunities for your organization. It is important that you understand when these new standards must be applied and how they differ from current accounting standards.

This article explains how ASNFPO, the new reporting standards for Canadian not-for-profit organizations, can affect your organization. It explains:

- The history of Canadian Accounting Standards for Not-for-Profit Organizations;
- Who can adopt the new standards and when they must be applied;
- Key differences between ASNFPO and current accounting standards; and
- Opportunities and requirements related to the initial application of these new standards.

History of Canadian Accounting Standards for Not-for-Profit Organizations

In 2006, the Canadian Accounting Standards Board (AcSB) announced that public companies in Canada would be required to adopt International Financial Reporting Standards (IFRS) commencing with periods beginning on or after January 1, 2011. This decision had implications for not-for-profit organizations as the AcSB launched a separate project to look at the needs of users of not-for-profit organization financial statements and evaluated whether it was worthwhile for these organizations to prepare financial statements in accordance with IFRS as well.

The AcSB decided that it was not necessarily in the best interest of the users of not-for-profit organization financial statements that those statements be prepared in accordance with IFRS. Instead, they created Canadian Accounting Standards for Not-for-Profit Organizations (ASNFPO), which were designed to meet the sector's needs for financial reporting. An organization that qualifies to adopt ASNFPO still has the option to adopt IFRS, if it so chooses.

What is the difference between ASNFPO and ASPE?

Accounting Standards for Private Enterprises (ASPE) are a full set of standards that were designed to meet the needs of Canadian private companies. ASNFPO contains the existing 4400 series of standards that have existed specifically for not-for-profit organizations since the 1990's and it also includes ASPE as its supplementary framework addressing relevant topics not covered in the ASNFPO framework (e.g. financial instruments, employee future benefits, etc.). The reason for including ASPE in these standards is that the AcSB decided it was appropriate for private enterprises and not-for-profit organizations to apply the same standards to transactions and circumstances that are common to both entities. Since there are some conceptual differences in how the two types of entities operate, ASNFPO also contains tailored sections that would replace similar provisions in ASPE, such as:

- Section 1001 – Financial Statement Concepts for Not-for-Profit Organizations;
- Section 1101 – Generally Accepted Accounting Principles for Not-for-Profit Organizations;
- Section 1401 – General Standards of Financial Statement Presentation for Not-for-Profit Organizations; and
- Section 1501 – First time Adoption by Not-for-Profit Organizations.

Which type of NFPO is your organization?

When the standard setters were developing these new standards, they also developed two different categories of not-for-profit organizations: private sector not-for-profit organizations and government sector not-for-profit organizations. Previously, all not-for-profit organizations followed the same framework but now there are different framework alternatives available to each type of not-for-profit organization:

Accounting Framework Options:	Private Sector NFPO's	Government Sector NFPO's
Canadian Accounting Standards for NPO's (Essentially the existing not-for-profit standards supplemented by the standards used by Canadian private companies)	✓	
International Financial Reporting Standards (IFRS) (The same framework used by publicly listed companies).	✓	
Public Sector Accounting Standards (The same framework used by government entities)		✓
Accounting Standards for Government NPO's (Essentially the existing not-for-profit standards supplemented by the standards used by government entities)		✓

Since different accounting framework options are available to the different types of not-for-profit organizations, it is imperative that the organization determine early on which definition of not-for-profit organization it meets.

The key difference between the two types of not-for-profit organizations is the concept of whether or not it is controlled by the government. Control is the power to govern the financial and operating policies of another organization with expected benefits or the risk of loss to the government from the other organization's activities. A government may choose not to exercise its power, but control would still exist by virtue of a government's ability to do so. Control must exist at the financial statement date, without the need to amend legislation or agreements.

If my organization is 100% government funded, are we controlled by the government?

An organization's financial dependence on the government, in and of itself, does not constitute control. While financial dependence would usually give rise to a relationship based on influence, it is unlikely that financial dependence alone would enable the government to control an organization. The governing body of that organization may make independent decisions on its financial and operating policies.

When do the new standards apply?

An organization must apply ASNFPO (or alternatively IFRS) to financial statements for periods beginning on or after January 1, 2012. An organization can adopt these standards earlier, if they wish.

Do many NFPO's intend on adopting IFRS?

Although private sector not-for-profit organizations do have the option of adopting IFRS instead of ASNFPO, it is not expected that many NPO's will decide to adopt IFRS. Adopting IFRS is more appropriate for organizations that have an international presence (foreign subsidiaries or chapters) or for organizations that have significant foreign funders or other users of the financial statements that would expect the financial statements to be prepared in accordance with IFRS.

Although IFRS may be appropriate for some NPO's, IFRS has not been developed with the needs and circumstances of NPO's in mind. IFRS was designed for organizations that make profit-oriented decisions and does not deal with specific issues particular to not-for-profit organizations.

For instance, there is no guidance in IFRS that deals with common NPO issues like fund accounting or accounting for contributions. IFRS does not contain guidance similar to the 4400 series in ASNFPO and it is unlikely that the international standard setters will develop such standards in the near future.

What are the key differences between ASNFPO and existing Canadian generally accepted accounting standards?

As discussed previously, some accounting matters that impact not-for-profit organizations are addressed in ASPE which NPO's apply when guidance is not provided within ASNFPO. The most significant changes facing not-for-profit organizations have to do with ASPE changes that apply to them. Some of the more notable changes are outlined below.

Financial Instruments

ASNFPO provided the AcSB with an opportunity to create a financial instrument standard that is simpler than the financial instrument standards contained in IFRS. Under ASNFPO, all financial instruments are to be measured at amortized cost except for the following items which will be subsequently measured at fair value:

- Investments in equity instruments whose prices are quoted in an active market
- Derivatives (unless the organization decides to designate the derivative as a hedge and apply hedge accounting)

ASNFPO also permits an organization to elect to subsequently measure any financial instrument at fair value. This election might be desirable when the organization has a mix of portfolio investments where some investments are subsequently measured at their fair value (e.g. shares in a public company) and others that, in absence of taking advantage of the election, would be subsequently measured at amortized cost (e.g. corporate bonds).

These new accounting standards have eliminated the use of categories to classify an organization's financial instruments. The impact of the changes to the financial instrument standards is dependent on what categories the organization previously used to classify its financial instruments. These changes have the most significant impact on portfolio investments and we have summarized the differences in the table on the following page:

<table>
<thead>
<tr><th>Type of Portfolio Investment</th><th>Options under Previous Standards</th><th>Options under ASNFPO</th></tr>
</thead>
<tbody>
<tr><td rowspan="2">Publicly traded equity securities</td><td>Held-for-trading – Carried at fair value and unrealized gains and losses are recognized in the statement of operations</td><td rowspan="2">Carried at fair value and unrealized gains and losses are recognized in the statement of operations</td></tr>
<tr><td>Available for sale – Carried at fair value and unrealized gains and losses are recognized in statement of changes in net assets</td></tr>
<tr><td rowspan="3">Fixed income securities</td><td>Held-for-trading - Carried at fair value and unrealized gains and losses are recognized in the statement of operations</td><td>Carried at amortized cost, applying either the effective interest or the straight line method</td></tr>
<tr><td>Available for sale – Carried at fair value and unrealized gains and losses are recognized in thestatement of changes in net assets</td><td rowspan="2">Carried at fair value and unrealized gains and losses are recognized in the statement of operations (only if management elects to do so)</td></tr>
<tr><td>Held to maturity – Carried at amortized cost using the effective interest method</td></tr>
</tbody>
</table>

Government Remittances

One new requirement under ASNFPO is that organizations are required to disclose the amount payable at the end of the period in respect of government remittances. Government remittances include federal and provincial sales taxes, payroll taxes, health taxes and workers' safety insurance premiums.

Asset Retirement Obligations

An asset retirement obligation exists when an organization ceases to use an asset and the organization is legally obligated to ensure that the asset is returned to an "acceptable state". What constitutes an acceptable state is usually defined in an agreement or in government regulations.

In Canada, we typically think of these types of obligations in the mining and oil and gas industries as companies operating in these industries frequently have an environmental obligation once they cease to operate on a certain site. However, these obligations can also be found in the not-for-profit sector. Some lease agreements may result in asset retirement obligations if a tenant made changes to a leased building but the lease requires that the tenant returns the leased space to its original state at the end of the lease term.

Existing accounting standards related to asset retirement obligations have very detailed and onerous recognition and measurement requirements. As a result, many organizations concluded it was not practical to determine asset retirement obligations in accordance with these standards. The AcSB acknowledged this fact and brought forward simpler requirements to account for asset retirement obligations and these standards apply to NPO's as well. Under the new standards, the amount recognized as an asset retirement obligation should be based on management's best estimate of the costs required to settle the present obligation at the date of the statement of financial position.

Intangible Assets

Existing Canadian GAAP for not-for-profit organizations provided minimal guidance with respect to accounting for intangible assets and prior to the introduction of ASNFPO, not-for-profit organizations were prohibited from applying the intangible asset standards that applied to profit oriented enterprises. Now, not-for-profit organizations have to follow the provisions of ASPE which provides significantly more guidance on how to account for common intangible assets such as development costs.

Under these new standards, an organization now has the option to expense or capitalize development costs that meet the following criteria:

- The project is technically feasible;
- The organization intends on completing the project and has sufficient resources available to do so;
- The organization can reliably measure the expenditures attributable to the development project;
- The organization can demonstrate how the intangible asset will generate probable future economic benefits (e.g. they can demonstrate that a market exists for the product or they can demonstrate the usefulness of the project if it is being developed for internal use).

Common examples of development costs would be the development of computer software (for sale or for internal use), the creation of a new web site to enable members to place orders for products or a new live production by a theatre group.

Pension Plans and other Future Employee Benefit Plans

Existing Canadian GAAP requires an organization to use the deferral and amortization approach to account for its defined benefit plans. Under ASNFPO, an organization is now provided with the option to adopt the immediate recognition approach.

The immediate recognition approach is much simpler to apply and is easier for users to understand than the deferral and amortization method. When determining the amount of the pension liability (or plan asset) under this approach, the organization recognizes the net amount of the actuarially determined accrued benefit obligation and the fair value of the plan assets at the statement of financial position date. Another key difference that simplifies the accounting process is that actuarial gains and losses and past service costs are expensed in the year that they occur.

Those considering adopting the immediate recognition approach should be aware that this method will result in a higher pension liability (or lower pension asset) and larger fluctuations in expense levels each year when compared to the deferral and amortization approach.

How do we report comparative figures when we adopt ASNFPO?

The ASNFPO must be applied retrospectively which means that all comparative financial statements presented must be prepared in accordance with ASNFPO.

In the first year that an organization applies ASNFPO, it is required to provide additional information to explain to users of the financial statements the impact of moving from the organization's previous standards to ASNFPO.

A key component of this disclosure is the requirement to provide an opening statement of financial position at the "date of transition." The date of transition to ASNFPO is the beginning of the earliest period for which an organization presents full comparative information under ASNFPO. For an organization that moves to ASNFPO for its December 31, 2012 year end, it would present comparative financial statements for the prior year (December 31, 2011) as well as a transitional statement of financial position as at January 1, 2011.

Under the transitional disclosure requirements, the organization is also required to provide a comparative statement of operations and cash flow statement in accordance with ASNFPO. This would cover the period from January 1, 2011 to December 31, 2011 in the example above. In addition, the organization is also required to provide the following transitional disclosures to help users reconcile changes to the comparative figures as a result of applying ASNFPO to those prior periods:

- An explanation of each transitional change brought about by the adoption of ASNFPO and the amount charged to opening net assets attributable to each change;
- A reconciliation of the net revenue reported in the organization's most recent previously issued financial statements to its net revenue under ASNFPO for the same period; and
- If an organization presented a cash flow statement under its previous accounting policies, it shall explain the material adjustments to the cash flow statement.

This seems like a complicated process. Is there any way to simplify it?

Although the disclosure requirements outlined above may seem complicated, for some organizations the transition to ASNFPO will be straightforward. For instance, the transition will likely be straightforward for organizations that do not have:

- Investments that are required to be measured at fair value and are currently designated as "available for sale";
- A pension plan; and
- Asset retirement obligations.

The AcSB has also introduced the first time adoption optional exemptions to ease the transition to ASNFPO. We have outlined some of these options below:

Employee future benefits
An organization will be able to elect to record any unamortized actuarial gains and losses and past service costs directly to opening net assets at the date of transition.

Financial instruments
At the date of transition to ASNFPO, an organization is permitted to designate any financial asset or financial liability to be measured at fair value. After the transition to ASNFPO, this election can only be made when a financial instrument is initially acquired or incurred.

Asset retirement obligations
Any adjustments made to the carrying amount of asset retirement obligations at the date of transition to ASNFPO can be charged to opening net assets.

Cumulative Transition Differences
Organizations will be able to elect to set cumulative translation adjustments that arose from operations to zero at the date of the transition.

Is there any other information about ASNFPO that we should be aware of?

One aspect of ASNFPO that has generated some discussion is the opportunity for an organization to revalue items of land, building and equipment at their fair value when it first applies ASNFPO. This one-time election is likely only of interest to organizations who own real estate property.

An organization may elect to measure any item of land, building and equipment at the date of transition to ASNFPO at its fair value and use that fair value as its deemed cost at that date. An organization taking advantage of this election would record a corresponding adjustment to its opening net assets. This is a one-time opportunity. If management does not make this election in the year it adopts ASNFPO, this option expires and is not available to be applied in a future year.

This election will result in the organization increasing the value of its assets and net asset position on its statement of financial position. However there are also drawbacks with the election such as the following:

- An appraisal will likely be required to substantiate the fair value of the asset which will result in incremental costs to the organization; and
- If the value of the building is increased then the organization's net revenue will decrease in future periods since the amortization expense attributable to the asset will increase. This may not be looked upon favorably by the organization's funders.

Management should carefully evaluate the advantages and disadvantages, and discuss them with their Welch LLP advisor, before they decide to take advantage of this election.

Conclusion

The transition to ASNFPO is an important junction in Canadian financial reporting. Organizations need to determine the impact it will have on their financial statements as this could have major implications on key financial metrics that may affect funding eligibility.

Please contact Christa Casey at: ccasey@welchllp.com or your Welch LLP representative to discuss ASNFPO and how they will affect your organization.

By Christa Casey, CA - Director, Not-for-Profit Sector