Financial Reporting Frameworks for Canada's Not-For-Profit Organizations – Comparing the Options

PUBLIC SECTOR

In our previous article, *Financial Reporting by Canada's Not-For-Profit Organizations – Change is Coming*, we observed that Canada's not-for-profit organizations (NPOs) will be required to transition away from existing Canadian generally accepted accounting principles (GAAP), as follows:

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- Government NPOs (GNPOs) will transition to the framework prescribed by the Public Sector Accounting Board (*PSA Handbook*). GNPOs are defined in the *PSA Handbook* as not-for-profit organizations that are controlled by the government. While indicators of control are provided in section 1300 of the *PSA Handbook*, any organization that is consolidated into a government's financial statements is controlled by that government
- Other NPOs will likely transition to a framework based on accounting standards for private enterprises (ASPE); although, International Financial Reporting Standards (IFRS) will be an option.

The distinction between GNPOs and other NPOs will result in different standards for similar organizations; for example, in health care and education, some entities are controlled by government, while others are not.

In recently released exposure drafts, Canada's Accounting Standards Board (AcSB) and the Public Sector Accounting Board (PSAB) have proposed standards that largely maintain the status quo for all NPOs, including GNPOs. The proposed financial reporting framework is substantially the same material that the AcSB developed in the 1990s and that NPOs have been following since 1997—often referred to as the 4400 series standards. More specifically, the framework maintains the special accounting rules for:

- Financial statement presentation, including both the restricted fund and deferral methods of accounting
- Contributions, revenue recognition, and contributions receivable
- Capital assets
- Collections, including works of art and historical treasures
- Reporting controlled and related entities, including those where the entity has control, significant influence, or another economic interest
- Disclosure of related party transactions
- Disclosure of allocated expenses.

While the transition model will help reduce the quantum of change for GNPOs in the short term, they may nonetheless encounter a number of changes in the basis of recognition and measurement of assets and liabilities, and the related revenues and expenses. In the following table, we have contrasted, at a high level, a number of significant differences between existing GAAP, the ASPE framework, and the PSAB framework that NPOs and GNPOs will need to address on transition.

Topic	Existing GAAP	PSA Handbook	ASPE
Employee future benefits – defined benefit pension plans	Deferral and amortization of actuarial gains and losses and past service costs; corridor method provides relief from amortization when such deferrals are less than 10 percent of the plan's assets or obligations	Actuarial gains and losses must be amortized; no corridor method	While existing deferral and amortization and corridor method may be followed, an option exists to adopt "immediate recognition method" wherein benefit obligation is based on funding valuation; all actuarial gains and losses and past service costs must be recognized immediately
Employee future benefits – plan amendments	Deferred and recognized based on employee average remaining service life (EARSL)	Recognized immediately	Deferred and recognized based on employee average remaining service life (EARSL)
Employee future benefits – discount rate	Market interest rates on high-quality debt instruments with matching cash flows or interest rate at which obligation could be settled	Short-term forecast of rates of return on assets held or cost of borrowing	Market interest rates on high-quality debt instruments with matching cash flows or interest rate at which obligation could be settled
Employee future benefits – measurement of assets	Market value with option to adjust to market over a period not to exceed 5 years	Market value with option to adjust to market over a period not to exceed 5 years	Fair value
Compensated absences – Benefits that accumulate but do not vest	Cost should be accrued when the event that obligates the entity occurs. Current *Handbook* indicates that, as a practical matter, entities are not required to accrue liabilities that accumulate but do not vest, such as sick leave benefits.	Cost should be accrued in period employee renders service	Cost should be accrued when the event that obligates the entity occurs
Investments reported using the equity method	Equity method requires the conformity of investee accounting policies with those of the investor	Modified equity whereby the investees' accounting policies are not adjusted to conform to those of the investor	Equity method requires the conformity of investees' accounting policies with those of the investor
Financial Instruments – Hedging	Hedge accounting available subject to appropriate documentation and assessment of effectiveness	Current proposal* does not include a provision for hedge accounting	Hedge accounting only available in specified situations where critical terms match
Financial Instruments – Embedded Derivatives	Subject to accounting separate from host instrument	Current proposal* requires embedded derivates to be accounted for separate from host instrument	No requirement to account for separately from host instrument
Financial Instruments – Investments	Prescribed rules for identifying investments to be carried at fair value/amortized cost	Current proposal* allows NPOs to elect fair value for any investment	Must carry equity investments and free-standing derivatives at fair value. May elect to carry any investment at fair value
Controlled profit related investments that meet specific criteria as a government business enterprise (GBE)**	Follow accounting standards for profit enterprise	IFRS	Following accounting standards for profit enterprises
Segment disclosures	Not applicable for not-for-profit organizations	Applicable if NPOs have more than one distinguishable activity	Not applicable

* PSAB does not currently include financial instruments, but an exposure draft has been developed. Current proposals identified above are obtained from that exposure draft.

** GBEs are separate legal entities with power to contract in their own name. GBEs can sue and be sued, are delegated the financial and operational authority to carry on a business, sell goods and services outside the government reporting entity as their principal activity, and can, in the normal course of operations, maintain their operations and meet their liabilities from revenue received outside the government reporting entity.

The following current *Handbook* sections do not have an equivalent section in the *PSA Handbook*. If guidance is required, a GNPO would, consistent with the requirements of PS1150.19 to PS1150.24, refer to other documents, such as US Government Accounting Standards Board, International Public Sector Accounting Standards Board, or Canadian Accounting Standards Board. PS1150 requires that the GNPO evaluate the context of the related pronouncement and ensure the conceptual framework is consistent.

- Asset retirement obligations
- Inventories
- Disposal of long-lived assets and discontinued operations
- Non-monetary transactions
- Current assets and liabilities

Both the PSAB and AcSB, in their exposure drafts, are proposing that the new standards (i.e. the transition model) be adopted by NPOs no later than their first fiscal year commencing on or after January 1, 2012. In the interim, NPOs and GNPOs can continue to follow their existing financial reporting framework, which is now referenced as Part V of the *CICA Handbook – Accounting*.

The PSAB will review the standards following their incorporation in the *PSA Handbook*, and will propose amendments. The AcSB has also indicated that they will continue to review the standards to identify necessary improvements and incorporate the evolution of private enterprise standards over time. Both the AcSB and PSAB have indicated they will work together with the goal that similar treatment will be accorded to similar transactions by all NPOs.

NPOs will want to watch carefully as the PSAB moves forward with its longer-term strategy. While GNPOs have avoided significant short-term change as a result of the PSAB's proposed interim transition model, there may be more significant changes to follow. KPMG Enterprise™ will continue to monitor developments and keep you advised.

If you have any views that you would like shared with the AcSB or PSAB, we would encourage you to communicate them directly to the Board, or share them with a KPMG Enterprise adviser who will ensure they are communicated to the appropriate recipient.

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