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Accounting Standards Improvements for Not-for-Profit Organizations

Special edition of Flash – April 2017

Flash bulletins provide a summary of the most recent news and publications from standard setters on accounting standards for private enterprises (ASPE), not-for-profit organizations (NPOs) and pension plans. This special edition of Flash specifically addresses the Exposure Draft issued by the Canadian Accounting Standards Board (AcSB) in February 2017 entitled *Accounting Standards Improvements for Not-for-Profit Organizations* which is relevant to NPOs who report under Part III of the *CPA Canada Handbook – Accounting – Accounting Standards for NPOs* (ASNPO).

This publication is intended to inform readers about recent changes in accounting; however, it cannot deal with all aspects of the Exposure Draft. Readers are always encouraged to refer to the original publications mentioned in the articles before making any decisions.

Overview

The AcSB's Exposure Draft was issued as part of its continuing project to retain and improve ASNPO. The Exposure Draft includes proposals that will affect all NPOs in the private sector that own tangible capital assets, intangible assets, collections or works of art, historical treasures and similar items not part of a collection.

The proposals

Tangible capital assets and intangible assets held by NPOs (new Sections 4433 and 4434)

The AcSB is proposing to replace Section 4431 *Tangible Capital Assets Held by Not-for-Profit Organizations* and Section 4432 *Intangible Assets Held by Not-for-Profit Organizations* with Section 4433 *Tangible Capital Assets Held by Not-for-Profit Organizations* and Section 4434 *Intangible Assets Held by Not-for-Profit Organizations*. The two new standards will direct NPOs to follow Section 3061 *Property, Plant and Equipment,* Section 3064 *Goodwill and Intangible Assets* and Section 3110 *Asset Retirement Obligations* in Part II of the *CPA Canada Handbook – Accounting – ASPE*, except for guidance included in Sections 4433 and 4434 related to items such as contributed assets and write-downs of assets.

Contributed assets and componentization

Section 4433 provides more guidance than its predecessor standard as to what is included in the cost of a contributed asset. The Exposure Draft proposes to measure a contributed capital asset at its fair value plus all other costs directly attributable to the acquisition (for example installation costs, site preparation costs, freight charges). By contrast, the current standard requires measurement at fair value. There would be no change in the exception to fair value measurement (i.e., measurement at a nominal amount) when the fair value cannot be readily determined.

The Exposure Draft proposes to direct NPOs to follow Section 3061 *Property, Plant and Equipment* in ASPE for all other recognition, measurement, presentation and disclosure requirements, with the exception of write-downs, which are discussed below. By applying the guidance in Section 3061, NPOs will be required to consider whether to allocate the cost of a tangible capital asset made up of significant separable component parts to those component parts. This componentization of the cost of a tangible capital asset would occur when practicable and when estimates can be made of the lives of the separate components.

Our thoughts

The proposals will require NPO to componentize tangible capital assets into significant component parts, when practicable, which may require additional effort to apply the requirements and additional tracking of the component parts of tangible capital assets for depreciation and replacement purposes.

Write-downs

For tangible capital assets or intangible assets, the new Sections would require the write-down of an asset to its fair value or replacement cost to reflect any partial impairments when:

- conditions indicate that the asset no longer contributes to a NPO's ability to provide goods and services; or
- conditions indicate that the value of future economic benefits or service potential associated with the asset is less than its net carrying amount.

Reversals of previously recorded write-downs would not be allowed. This proposed requirement is a significant change from current standards, which require a write-down once the asset no longer has any long-term service potential to the organization and is thus fully impaired. In other words, the current model does not contemplate partial impairments.

Proposed examples of conditions that may indicate that the future economic benefits or service potential associated with a tangible capital asset or intangible asset have been reduced such that a write-down may be appropriate include, but are not restricted to:

- A significant decrease in, or cessation of, the need for the services provided by the asset;
- A significant adverse change in the extent or manner in which the asset is being used or its physical condition;
- A significant adverse change in legal factors or in the operating environment that could affect its value;
- An accumulation of costs significantly in excess of the amount originally expected for its acquisition, development or construction;
- A current expectation that, more likely than not, the asset will be sold or otherwise disposed of significantly before the end of its previously estimated useful life; or
- A significant decrease in its market price.

Many NPOs hold tangible capital assets or intangible assets whose future economic benefits or service potential may not be directly related to their ability to generate net cash flows. As proposed, when a NPO notes conditions that indicate an impairment, it would write-down those assets to fair value (the amount that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act) or replacement cost (the amount that would be needed currently to acquire an equivalent asset). The Exposure Draft has proposed providing a choice between fair value and replacement cost since it is believed that, in many cases, determination of an asset's fair value may be too onerous for a NPO.

Our thoughts

The requirements related to assessing tangible capital assets and intangible assets for indicators of impairment and calculating partial impairments will require more effort for NPOs and may result in the recognition of impairments earlier than the full impairment model followed in the current standards.

Disclosure

When a NPO recognizes a write-down, it will be required to disclose whether a tangible capital asset or intangible asset was measured at its fair value or replacement cost. It will also be directed to the disclosure requirements in ASPE Section 3063 *Impairment of Long Lived Assets* which include a description of the impaired asset, the facts and circumstances leading to the impairment, the amount of the impairment loss, and the caption in the statement of operations that includes that loss.

Transition

Prospective application of Sections 4433 and 4434 would be required with transitional relief for NPOs to:

- allocate the costs of tangible capital assets to their component parts based on their relative cost or fair value at the date the assets were acquired, or at fair value or replacement cost at the date the Section is first applied; and

- recognize an adjustment to opening net assets for partial impairments of tangible capital assets and intangible assets existing at the date the Sections are first applied.

Collections (new Section 4441)

Recognition and measurement

The AcSB is proposing to replace Section 4440 *Collections Held by Not-for-Profit Organizations* with Section 4441 *Collections Held by Not-for-Profit Organizations.* Collections are defined in both standards as works of art, historical treasures or similar assets that are:

- held for public exhibition, education or research;
- protected, cared for and preserved; and
- subject to an organizational policy that requires any proceeds from their sale to be used to acquire other items to be added to the collection, or for the direct care of the existing collection.

Under current Section 4440, NPOs are not required to record collections on their statement of financial position, although they are not precluded from doing so. The Exposure Draft proposes requiring recognition of collections in the statement of financial position. NPOs would have an accounting policy choice to record collections at cost or at a nominal value, and that choice would apply to all collections. Cost would be determined based on the amount of consideration given up to acquire the items in the collection, including all costs directly attributable to their acquisition. The cost of contributed assets would be deemed to be fair value at the date of the contribution, plus directly attributable costs. If fair value cannot be reasonably determined, a nominal value could be used. The costs incurred to protect and preserve items in a collection would be expensed as a repair or maintenance expense. Consistent with the current standard, collections would not be subject to amortization due to their nature of being preserved into perpetuity.

Write-downs

Under the proposals, the value of a collection recorded in the statement of financial position at cost would be written down whenever events or changes in circumstances indicate that its net carrying amount may exceed its fair value. In these cases, the collection would be written down to its fair value or replacement cost. Reversals of previously recorded write-downs would not be allowed.

Disclosure

In addition to the disclosures required in current Section 4440, Section 4441 would also require separate presentation in the statement of financial position of amounts recognized as a collection, and would require additional disclosure when a write-down of a collection is recognized.

Transition

The AcSB proposes retrospective application of Section 4441, with transitional relief provided for NPOs that choose to record their collections at cost as follows:

- NPOs can capitalize items in a collection acquired in previous periods at their cost or fair value at the date of acquisition, or at their fair value or replacement cost at the date the Section is first applied.
- When the cost of one or more items in a collection cannot be reasonably determined, the NPO can record those items at a nominal value, which does not preclude the measurement of the other items in the collection at their cost.
- NPO can recognize an adjustment to opening net assets for partial impairments of collections existing at the date the Section is first applied.

Our thoughts

The exception that would allow NPOs to measure one or more of the items in their collections at a nominal value if their value cannot be reasonably determined should reduce the amount of work for NPOs that did not previously recognize their collections.

Works of art, historical treasures and similar items that are not part of a collection

The Exposure Draft is proposing that NPOs continue to account for works of art, historical treasures and similar items that are not part of a collection as tangible capital assets, intangible assets, investments or inventory, depending on their intended use.

Effective date

The AcSB proposes making the new standards effective for fiscal years beginning on or after January 1, 2019.

Conclusion

Our overall thoughts

This first exposure draft in the AcSB's process of improving ASNPO implements a number of the proposed principles in their 2013 Statement of Principles that respondents mostly agreed with. It aligns ASNPO with much of the ASPE guidance related to tangible capital assets and intangible assets that was fairly similar, while dealing with NPO-specific issues, such as measuring impairment and contributed tangible capital and intangible assets. While some of the proposed changes will require additional effort by NPOs, the transitional guidance will allow for some exceptions to make it easier to move to the new standards for tangible capital assets, intangible assets and collections.

If these changes affect you and your NPO, the AcSB is interested in hearing your comments on the Exposure Draft. Respondents are asked to send their comments by May 31, 2017. If you have any questions about the proposals, please reach out to your Grant Thornton advisor.