

# **Accounting Standards for Not-for-Profit Organizations**

## **— Background Information and Basis for Conclusions**

### **Foreword**

In December 2010, the Accounting Standards Board (AcSB) released Part III of the CICA Handbook – Accounting, which consists of accounting standards for not-for-profit organizations. The AcSB has approved for publication the contents of this document setting out its rationale for adopting those standards.

Background Information and Basis for Conclusions documents are sources of generally accepted accounting principles, as described in GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, Section 1101, in Part III of the Handbook. These documents are intended to help readers understand how the AcSB reached its conclusions, but they do not include explanations of requirements or guidance on the application of the relevant Section or Accounting Guideline.

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## **INTRODUCTION**

- 1 This document summarizes considerations that were deemed significant by members of the Accounting Standards Board (AcSB) in reaching its conclusions in developing the new set of accounting standards for not-for-profit organizations. It sets out the reasons the AcSB undertook the project to develop the new framework, the consultation process, the key decisions made, and the principal reasons for adopting the positions taken and rejecting others. Individual AcSB members gave greater weight to some factors than to others.
- 2 Nothing in this document is to be taken as overriding the requirements of the CICA Handbook – Accounting. However, the discussion may help readers to understand how the AcSB reached its conclusions in developing the new framework and the AcSB's intent with respect to its interpretation and application.

## **BACKGROUND**

- 3 In its Strategic Plan for 2006-2011, the AcSB noted, "one size does not necessarily fit all" and decided to pursue separate strategies for publicly accountable enterprises, private enterprises and not-for-profit organizations. These strategies reflect the different needs of users and different cost-benefit considerations in each sector resulting from the different transactions they undertake and the different circumstances they encounter.
- 4 The AcSB has replaced the previously applied set of standards under Canadian generally accepted accounting principles with International Financial Reporting Standards (IFRSs) for publicly accountable profit-oriented enterprises. Those standards are now included in Part I of the Handbook.
- 5 The AcSB decided that a not-for-profit organization may apply IFRSs if that approach meets the needs of the users of its financial statements. In reaching this decision, the AcSB noted that IFRSs do not contain any standards dealing with issues specific to not-for-profit organizations, equivalent to the "4400 series" of Sections in the pre-changeover standards Part V of the Handbook. Furthermore, it is unlikely that the International Accounting Standards Board (IASB) will develop such standards in the foreseeable future.
- 6 The AcSB has also developed "made in Canada" financial reporting standards for private enterprises. Those standards are now included in Part II of the Handbook. The AcSB decided to consider permitting not-for-profit organizations to apply the standards for private enterprises to transactions and circumstances that are common to those entities and not-for-profit organizations. Accordingly, the AcSB's Not-for-Profit Organizations Advisory Committee monitored the development of the private enterprise standards now in Part II of the Handbook.
- 7 Under its Strategic Plan for 2006-2011, the AcSB undertook an examination of the needs of the financial statement users of not-for-profit organizations in order to determine, based on that examination, the most appropriate financial reporting strategy.
- 8 In December 2008, the AcSB and the Public Sector Accounting Board (PSAB) issued a joint Invitation to Comment, "Financial Reporting by Not-for-Profit Organizations," to solicit views on the best approach to developing standards for not-for-profit organizations in both the private and public sectors.
- 9 The Invitation to Comment described the Boards' responsibilities for setting financial reporting standards for private and public sector not-for-profit organizations, and acknowledged the diverse needs and perspectives inherent in Canadian not-for-profit organizations.
- 10 The Boards tentatively concluded that they would not propose developing a set of stand-alone standards for private and public sector not-for-profit organizations. Rather, the Boards had been advised that the standards in the 4400 series of Sections had served the needs of not-for-profit organizations well in the past. Thus, the Boards each proposed options for future financial reporting within the private and public sectors that included retention of that series of standards.
- 11 The AcSB received substantial input from not-for-profit organizations and their stakeholders through roundtable meetings and comment letters. This input emphasized the diversity of Canadian not-for-profit organizations and the resultant diversity of users' needs. This diversity was the basis of strong support for providing not-for-profit organizations with options for financial reporting.
- 12 Stakeholders generally supported existing standards for not-for-profit organizations for their relevance and high quality. Stakeholders also agreed with the AcSB's preliminary assessment that a stand-alone set of standards should not be developed for not-for-profit organizations. Thus, stakeholders strongly supported linking not-for-profit organization standards to the accounting standards being developed for private enterprises. Respondents also supported giving not-for-profit organizations the option of adopting IFRSs.
- 13 The AcSB considered the comments received on the Invitation to Comment and issued an Exposure Draft, "Accounting Standards for Not-for-Profit Organizations," in March 2010, addressing the future direction for setting standards for private sector not-for-profit organizations, and the timing of the changeover from the existing standards now contained in Part V of the Handbook.
- 14 The AcSB received 54 comment letters, the majority from public practitioners and financial statement preparers. Input was also received through public roundtables and other discussions held across the country.

- 15 The vast majority of respondents supported the direction the AcSB had taken in developing the Exposure Draft. However, many respondents recommended specific changes to the Exposure Draft proposals. Some of the recommendations were adopted in finalizing the proposed standards, some were considered and rejected, and some will be referred to the next phase of improving standards for not-for-profit organizations described under "Next Steps" below.
- 16 The AcSB discussed the issues raised in the responses to the Exposure Draft at its September 2010 meeting and approved the accounting standards set out in Part III of the Handbook, substantially as proposed in the Exposure Draft. The main features of the new set of standards for not-for-profit organizations are discussed below.
- 17 The approach to setting standards in this manner reflects the AcSB's position that there should be no differences in accounting between profit-oriented enterprises and not-for-profit organizations when the circumstances and transactions are the same. Other matters that are unique to not-for-profit organizations are included in Part III of the Handbook.
- 18 PSAB issued its own Exposure Draft, considered input received in response to its Exposure Draft, and adopted a version of the 4400 series of Sections appropriately modified to fit within public sector standards. Government not-for-profit organizations are now required to follow public sector standards. Information about PSAB's activities is available on its website at <http://www.frascanada.ca/standards-for-public-sector-entities/index.aspx>. Information about the amendments PSAB has made to the CICA Public Sector Accounting Handbook in respect of government not-for-profit organizations is provided in its Basis for Conclusions.

## **MAIN FEATURES OF THE STANDARDS**

### **Availability**

- 19 Based on stakeholder comments received during both the Invitation to Comment and the Exposure Draft processes, the AcSB determined that not-for-profit organizations reporting in accordance with Canadian GAAP may use the standards applicable to publicly accountable enterprises (IFRSs in Part I of the Handbook) or the accounting standards for not-for-profit organizations in Part III of the Handbook.
- 20 Consistent with its approach in setting standards for profit-oriented enterprises, the AcSB determined that any not-for-profit organization can use the accounting standards for not-for-profit organizations. There is no size test or other qualifier to use these standards.
- 21 To simplify matters for stakeholders, the AcSB decided to consolidate the specific standards applicable to not-for-profit organizations in Part III of the Handbook and to link those standards to the accounting standards for private enterprises in Part II of the Handbook for transactions and circumstances that are not dealt with in Part III.
- 22 In order to proceed in a timely manner to settle the strategic issues, the AcSB decided to make no substantive changes to the existing 4400 series of standards or other Sections that pertained to not-for-profit organizations in Part V of the Handbook.
- 23 The Sections in Part III of the Handbook apply only to not-for-profit organizations. These Sections deal with matters that are unique to not-for-profit organizations or with issues where the needs of financial statement users indicate that different requirements from those that apply to profit-oriented enterprises are appropriate.

### **Free choice**

- 24 Given the diversity of not-for-profit organizations, the AcSB agreed that options were required and that the choice between the options should be one that an organization can make freely. The AcSB adopted a free choice of the accounting standards for not-for-profit organizations in Part III of the Handbook, or IFRSs in Part I of the Handbook. In deciding on the approach, the AcSB noted that IFRSs do not, and it is expected will not, contain an "add on" equivalent to the existing 4400 series in the Handbook.

### **Stand-alone standards**

- 25 The accounting standards for not-for-profit organizations are not a stand-alone set of standards. They require reference to another set of standards (i.e., those in Part II of the Handbook) to address some issues or for additional guidance on others. A not-for-profit organization applying Part III of the Handbook also applies the standards in Part II to the extent that the Part II standards address topics of general applicability not covered in Part III or topics that apply to the not-for-profit organization's transactions or circumstances.
- 26 GENERALLY ACCEPTED ACCOUNTING PRINCIPLES FOR NOR-FOR-PROFIT ORGANIZATIONS, Section 1101 clarifies the inter-relationship of Part III with the standards in Part I of the Handbook and, in particular, with Part II of the Handbook.

### **Conceptual framework**

- 27 The AcSB concluded that the conceptual framework is relevant to financial reporting by all Canadian entities. Thus, the existing conceptual framework in Part V of the Handbook is retained in FINANCIAL STATEMENT CONCEPTS FOR NOT-FOR-PROFIT ORGANIZATIONS, Section 1001.

### **Future changes**

- 28 The accounting standards for not-for-profit organizations will not be static. Any high-quality set of accounting standards must evolve in order to address reporting needs in a changing environment.
- 29 In comparison to publicly accountable enterprises and some private enterprises, not-for-profit organizations generally have fewer resources to devote to keeping up to date with standards. Therefore, as accounting standards for private

enterprises evolve over time, the AcSB intends to co-ordinate those changes with changes to not-for-profit organization standards, as appropriate. In this regard, the AcSB plans to update the accounting standards for private enterprises on an annual or biennial basis, with each update potentially consisting of changes to several standards that would all be effective at the same time. The AcSB believes that this bundling of changes will be sensitive to the needs of both private enterprises and not-for-profit organizations.

- 30 As well, future changes to IFRSs will be considered to determine the extent that they are appropriate for Canadian private enterprises and not-for-profit organizations. Input received from stakeholders supported reviewing IFRSs for potential changes to the accounting standards for private enterprises, as this minimizes confusion in the marketplace and the educational and training burden for those who need to work with both of those sets of standards. Any changes to private enterprise standards have the potential to affect not-for-profit organizations as well.

## **COMPONENTS OF THE NEW STANDARDS**

### **Introduction to Part III**

- 31 The table in the Introduction to the 4400 series of Sections in Part V of the Handbook was not retained in the Introduction to Part III. The table was considered to be ambiguous and was being used by some as though it were a standard in its own right rather than simply guidance. The allocation of individual standards to the columns in the table in Part V headed "Applies to NFPs with relevant transactions or circumstances" and "Limited or no applicability to NFPs" was somewhat arbitrary. Organizations interpreted how each column applied to their transactions and circumstances differently.

### **Section 1001**

- 32 The AcSB concluded that it would be appropriate to include FINANCIAL STATEMENT CONCEPTS FOR NOT-FOR-PROFIT ORGANIZATIONS, Section 1001, as it contains material basic to the underpinnings of not-for-profit standards that was contained in the corresponding Section in Part V of the Handbook but was deleted from the equivalent Section in Part II of the Handbook. The conceptual framework in Part V of the Handbook has been retained without change other than to omit references specific to the circumstances of profit-oriented enterprises.

### **Section 1101**

- 33 The AcSB determined that basic material specific to not-for-profit organizations should be included in Part III of the Handbook and, accordingly, GENERALLY ACCEPTED ACCOUNTING PRINCIPLES FOR NOT-FOR-PROFIT ORGANIZATIONS, Section 1101, clarifies the inter-relationship of Part III with Part I of the Handbook and, in particular, Part II of the Handbook. The AcSB subsequently decided to delete a reference to Board-authorized implementation guidance in Section 1101 because there is no such guidance for Part III of the Handbook.

### **Section 1401**

- 34 GENERAL STANDARDS OF FINANCIAL STATEMENT PRESENTATION FOR NOT-FOR-PROFIT ORGANIZATIONS, Section 1401, retains fundamental standards applicable to all entities.

### **Section 1501**

- 35 The AcSB concluded that it would be appropriate for Part III of the Handbook to include a Section on first-time adoption specific to not-for-profit organizations. The Exposure Draft proposed that business combinations and fair value provisions applicable to private enterprises would not apply to not-for-profit organizations. Based on a number of comments indicating that the provisions should also be available to not-for-profit organizations, the AcSB reintroduced FIRST-TIME ADOPTION BY NOT-FOR-PROFIT ORGANIZATIONS, paragraphs 1501.10-13, in finalizing the Section.

- 36 The AcSB subsequently amended Section 1501 to permit an organization that accounts for its defined benefit plans using the deferral and amortization approach described in EMPLOYEE FUTURE BENEFITS, Section 3461 in Part II of the Handbook, to carry forward at the date of transition to accounting standards for not-for-profit organizations any unrecognized actuarial gains and losses and past service costs that were determined previously in accordance with Section 3461 in Part V of the Handbook.

### **Section 3032**

- 37 INVENTORIES HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 3032, retains material in the corresponding Section in Part V of the Handbook related to contributions of materials and services, and inventories to be distributed at no charge or for a nominal charge. That material was not included in INVENTORIES, Section 3031 in Part II of the Handbook, as it was not considered to be applicable to private enterprises.

### **Section 4400**

- 38 FINANCIAL STATEMENT PRESENTATION BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4400, has been amended to remove material related to interim financial statements and material that conformed with the concept of other comprehensive income, which previously required some results to be reported in the statement of changes in net assets. Those two matters are not included in the standards in Part II of the Handbook. In all other respects, the Section in Part III of the Handbook is substantively the same as the corresponding Section in Part V of the Handbook.

- 39 The illustrative examples in Section 4400 have been amended to include material derived from Emerging Issues Committee Abstract of Issues Discussed EIC-123, Reporting Revenue Gross as a Principal versus Net as an Agent.

40 The financial statement examples contained in Section 4400 have been eliminated. The AcSB is minimizing illustrative examples in the development of standards as it believes there are more appropriate ways of making this type of supporting information available. For example, the Not-for-Profit Organizations Advisory Committee felt that eliminating the examples from Section 4400 and, instead, encouraging the development of an updated Not-for-Profit Financial Reporting Guide would save the AcSB from having to amend Section 4400 every time relevant standards in Parts II and III of the Handbook changed in a way that required updating of examples.

#### **Sections 4410 and 4420**

41 CONTRIBUTIONS – REVENUErecognition, Section 4410, and CONTRIBUTIONS RECEIVABLE, Section 4420, are essentially unchanged from the corresponding Sections in Part V of the Handbook.

#### **Sections 4431 and 4432**

42 As noted above, the AcSB's position is that there should be no differences in accounting between profit-oriented enterprises and not-for-profit organizations when the circumstances and transactions are the same, other than for matters addressed in the 4400 series of Sections dealing with transactions and circumstances that are unique to not-for-profit organizations. Development costs incurred by not-for-profit organizations were not covered by CAPITAL ASSETS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4430 in Part V of the Handbook. The AcSB was also concerned that certain of the costs being deferred by not-for-profit organizations are inconsistent with FINANCIAL STATEMENT CONCEPTS FOR NOT-FOR-PROFIT ORGANIZATIONS, paragraphs 1001.46 and 1001.48.

43 The AcSB received a number of comment letters on its Exposure Draft that specifically referred to this issue. The AcSB discussed this matter on three separate occasions. As there were no persuasive arguments put forward in support of the premise that there is anything unique about not-for-profit organizations in this area of accounting, the AcSB rejected the arguments that not-for-profit organizations should get special accounting treatment for their development costs.

44 Accordingly, the AcSB decided that the provisions of GOODWILL AND INTANGIBLE ASSETS, Section 3064 in Part II of the Handbook, should apply to development costs. Such costs include those related to a series of plays or concerts, gallery exhibitions, and fundraising events and campaigns. The guidance on other types of costs addressed by Section 3064, such as selling, administrative and other general overhead expenditures, also applies.

45 In order to clarify its position as to the applicability of Section 3064 in Part II of the Handbook to not-for-profit organizations, the AcSB decided not to retain CAPITAL ASSETS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4430 in Part V of the Handbook, but to replace it with two new Sections: TANGIBLE CAPITAL ASSETS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4431, and INTANGIBLE ASSETS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4432. Section 4431 retains the provisions of Section 4430 as they apply to tangible capital assets (property, plant and equipment). Section 4432 directs not-for-profit organizations to apply the provisions of Section 3064, other than those dealing with impairment to intangible assets. Section 4432 incorporates the same impairment requirements as Section 4431.

#### **Sections 4440 to 4470**

46 Sections 4440-4470 are essentially unchanged from the corresponding Sections in Part V of the Handbook.

#### **EIC Abstracts**

47 Other than incorporating the examples in EIC-123 into FINANCIAL STATEMENT PRESENTATION BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4400, as described in paragraph 39 above, the AcSB has not carried forward EIC Abstracts specifically related to not-for-profit organizations in Part III of the Handbook. The AcSB concluded that practice has sufficiently developed in the period subsequent to the issuance of EIC Abstracts that the material contained in those Abstracts did not need to be included in Part III.

#### **EFFECTIVE DATE**

48 The accounting standards for not-for-profit organizations are effective for fiscal years beginning on or after January 1, 2012. This effective date is a year later than the effective date for accounting standards for private enterprises in Part II of the Handbook to give not-for-profit organizations adequate time to prepare for the changes. The AcSB did not receive comments in Exposure Draft responses indicating that this would impose an undue burden on the not-for-profit sector. Earlier application of the standards is permitted.

#### **TRANSITIONAL PROVISIONS**

49 The AcSB recognizes that most organizations adopting the accounting standards for not-for-profit organizations will have previously prepared financial statements on the basis of the pre-changeover standards in Part V of the Handbook. However, the AcSB also expects that some organizations that previously did not prepare GAAP financial statements will adopt the standards in Part III of the Handbook, either in 2012 or at some later date. In most circumstances, an organization will likely need to make some accounting policy changes.

50 ACCOUNTING CHANGES, Section 1506 in Part II of the Handbook, generally requires retrospective application on adoption of new accounting policies. The AcSB decided that this should be the general principle for initial adoption of Part III of the Handbook, but recognized that for some individual standards this might result in significant difficulties.

The AcSB also noted that applying some requirements retrospectively may lead to selective application designed to report a specific result or may require the inappropriate use of hindsight.

- 51 The AcSB developed FIRST-TIME ADOPTION BY NOT-FOR-PROFIT ORGANIZATIONS, Section 1501, to ensure that an organization's first financial statements prepared using the accounting standards for not-for-profit organizations contain high-quality information that:
- (a) is transparent for users and comparable over all periods presented;
  - (b) provides a suitable starting point for accounting under the standards for not-for-profit organizations; and
  - (c) can be generated at a cost that does not exceed the benefits to users.

Section 1501 is based on the approach in FIRST-TIME ADOPTION, Section 1500 in Part II of the Handbook.

- 52 The AcSB recognized that the transitional issues facing individual organizations will differ, depending on their previous basis of accounting and the nature of their activities (among other factors), and that some organizations will face only minor transitional issues. However, the AcSB views the accounting standards for not-for-profit organizations as a new basis of accounting and, accordingly, decided that all first-time adopters should be able to take advantage of the same transitional provisions.

#### **NEXT STEPS**

- 53 The AcSB notes that, as the standards themselves are not substantially changing, the adoption of Part III of the Handbook is not likely to result in a significant change in many not-for-profit organizations' financial reporting practices.
- 54 However, the AcSB was advised during the consultation process related to the Invitation to Comment that the existing financial reporting standards for not-for-profit organizations can and should continue to be improved. Similarly, respondents to the Exposure Draft made a number of useful suggestions for amendments to the standards that the AcSB concluded should be addressed. Over the course of developing and implementing its new strategies for setting standards for the not-for-profit sector, the AcSB intends to review the content of the standards in Part III of the Handbook to determine if they remain appropriate after having been applied in practice for a number of years.
- 55 The AcSB and PSAB will work jointly to reconsider the current requirements of the 4400 series Sections to identify necessary improvements now that both Boards have finalized their respective strategic directions for not-for-profit organizations. The Boards' objective is to have all not for-profit organizations apply similar accounting treatments to like transactions when the needs of users in the private and public sectors are aligned.
- 56 The Boards have appointed a joint task force to develop recommendations for improved standards for the unique transactions and circumstances of not-for-profit organizations in both sectors. The task force commenced in January 2011.
- 57 Subject to the outcome of that review, the AcSB expects to propose amendments to the standards. Stakeholders will be provided with the opportunity to comment on any future proposals to amend the not-for-profit standards prior to their adoption.

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