Accounting Standards Improvements for Not-for-Profit Organizations — Background Information and Basis for Conclusions

Foreword

In March 2018, the Accounting Standards Board (AcSB) released TANGIBLE CAPITAL ASSETS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4433, INTANGIBLE ASSETS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4434, and COLLECTIONS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4441 in Part III of the CPA Canada Handbook – Accounting. The AcSB has approved for publication the contents of this document setting out its rationale for these standards.

Background Information and Basis for Conclusions documents are sources of generally accepted accounting principles, as described in GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, Section 1100 in Part II 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.

March 2018

INTRODUCTION

1 This document summarizes considerations that were deemed significant by the members of the AcSB in reaching their conclusions in developing TANGIBLE CAPITAL ASSETS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4433, INTANGIBLE ASSETS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4434 and COLLECTIONS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4441 in Part III of the Handbook. Section 4433 replaces TANGIBLE CAPITAL ASSETS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4431, Section 4434 replaces INTANGIBLE ASSETS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4432 and Section 4441 replaces COLLECTIONS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4440. This document sets out the reasons the Board undertook the project to develop this material, the process of research and deliberation, the key decisions made, and the principal reasons for adopting the positions taken and rejecting others. Individual Board members gave some factors greater weight than other ones.

2 Nothing in this document is to be taken as overriding the requirements of the Handbook. However, the discussion may help readers understand how the AcSB reached its conclusions in developing the Sections and the Board's intent with respect to interpretation and application of the Sections.

BACKGROUND

3 In April 2013, the AcSB and Public Sector Accounting Board (PSAB) issued a joint Statement of Principles, "Improvements to Not-for-Profit Standards." The Statement of Principles was developed after significant consultations with not-for-profit stakeholders in both the private and public sectors.

4 Since the issuance of the Statement of Principles, the AcSB carried out extensive consultations to reach its stakeholders, including several cross-country roundtable meetings as well as various private meetings with interested groups. The Board met independently and jointly with PSAB to discuss the responses received on the Statement of Principles. Since that time, the Board also developed its 2016-2021 Strategic Plan, which outlines the Board's vision, how it intends to operate and the broad policy objectives that will guide its standard-setting activities. The strategies provide a basis for, and promote, stakeholder confidence in the information reported by publicly accountable enterprises, private enterprises, not-for-profit organizations (NFPOs) and pension plans. As part of the strategic-planning process relating to Part III, the Board has reaffirmed its commitment to continue to:

(a) maintain a separate set of standards for private sector NFPOs that addresses transactions and circumstances unique to such organizations;

(b) review the standards in Part III and update the standards as necessary; and

(c) work with PSAB, with the objective of achieving consistency between private and public sector standards for NFPOs when appropriate.

5 In response to the feedback from private sector stakeholders to the Statement of Principles and as part of its commitment to improve the standards in Part III, in March 2015 the AcSB decided to divide the principles among three projects:

(a) Accounting Standards Improvements;

(b) Reporting Controlled and Related Entities by NFPOs; and

(c) Contributions – Revenue Recognition and Related Matters.

6 To assist the AcSB in achieving its mandate, the Board established a new permanent committee for NFPOs in January 2016. The Not-for-Profit Advisory Committee (the "Advisory Committee") provides the Board with expertise and input on issues relating to accounting standards for private sector NFPOs, including input about the development of Sections 4433, 4434 and 4441. The Advisory Committee includes auditors, preparers and financial statements users, including grantors, with a range of backgrounds and experience from across Canada. Members include representatives from organizations of differing sizes and in a variety of industries; some organizations provide benefit to its members and others serve the public.

7 As part of the AcSB's project on Accounting Standard Improvements, the Board released the Exposure Draft, "Accounting Standards Improvements for Not-for-Profit Organizations," in February 2017. The Exposure Draft addressed the principles that received general acceptance from Statement of Principles respondents, covering topics regarding tangible capital assets, intangible assets and collections. In deliberating the individual issues, the Board considered

input from the Advisory Committee, the comment letters received on the Exposure Draft, as well as the feedback obtained from stakeholders on the Statement of Principles. The Board also considered reporting practices for NFPOs in other jurisdictions to understand accounting outcomes and best practices globally.

EFFECTS ANALYSIS

8 In developing these new standards, the AcSB considered the consequences of adopting them relative to the objective of financial statements and the benefit versus cost constraint. As described in FINANCIAL STATEMENT CONCEPTS FOR NOT-FOR-PROFIT ORGANIZATIONS, paragraph 1001.12, the "objective of financial statements is to communicate information that is useful to members, contributors, creditors and other users ('users') in making their resource allocation decisions and/or assessing management stewardship."

9 The AcSB is committed to updating accounting standards for NFPOs, as necessary, to ensure these standards continue to meet the needs of users of private sector NFPO financial statements. In executing on this commitment, the Board seeks to understand the differing needs of these users. Based on that understanding, the Board decides, on a case-by-case basis, the extent to which a standard that is being improved should align with or differ from the corresponding public sector NFPO standard (issued in the CPA Canada Public Sector Accounting (PSA) Handbook). Paragraphs 10-20 highlight the effects of the new standards.

Tangible capital assets and intangible assets

10 The AcSB recognized that, since NFPOs with revenues less than $500,000 are permitted to limit the application of Sections 4433 and 4434, the effects of the new standards would be minimal for smaller organizations. Respondents were generally supportive of this threshold, with some respondents suggesting it should be increased as the costs of applying Sections 4433 and 4434 may exceed the benefit for small NFPOs. The Board noted that in the future it will re-examine this exemption, and will consider this feedback from respondents.

11 A primary effect of the new standards is an expected improvement in the comparability in financial reporting by removing duplicate guidance in Parts II and III for tangible capital assets and intangible assets in Part III. During its strategic plan consultations, stakeholders informed the AcSB that having common guidance in Parts II and III that results in common reporting improves understandability of the information, especially for those stakeholders who deal with both Parts II and III. The requirement in the new standards regarding the recognition of partial impairments of tangible capital assets and intangible assets, as well as the requirement to separate a tangible capital asset into its component parts, is expected to result in improved comparability in financial reporting between NFPOs in the private sector and other private sector enterprises.

12 The AcSB acknowledged that the requirements for componentization could affect many NFPOs. Some additional work by preparers may be required to apply the componentization guidance and additional costs may be incurred to have this information audited. However, the Advisory Committee informed the Board that some NFPOs already have the information and a few organizations already componentize tangible capital assets, and for many other NFPOs, the need to componentize would be limited or possibly not material. Some Advisory Committee members reflected on how capital maintenance of NFPO assets could be important to some NFPOs and their users and, therefore, thought that componentization would be useful in those circumstances. The Board agreed that componentization could support better governance as it provides users with information that can assist with managing assets. Further, the Board noted that componentization is an existing requirement for private enterprises in Part II and was carried forward from the pre-changeover standards in Part V.

13 The AcSB also recognized the costs to preparers of assessing and calculating partial impairments, including the costs of getting this information audited. However, the Board received feedback that partial impairments are infrequent and usually result from redundancies or damage to assets.

14 As a result of applying Section 4433, the requirements for the capitalization, amortization, write-down and disposal of tangible capital assets for NFPOs will not differ substantially between NFPOs in the private sector and NFPOs in the public sector that do not use Sections PS 4200 to PS 4270 (the PS 4200 series) in the PSA Handbook. However, for intangible assets accounted for in accordance with Section 4434, there will continue to be a lack of comparability between NFPOs in the private sector and NFPOs in the public sector that do not use the PS 4200 series until the PSA Handbook addresses the accounting for intangible assets. Currently, intangible assets are not generally recognized as assets in the public sector.

15 Additionally, the requirement to recognize partial impairments for tangible and intangible assets and the componentization of tangible assets will create a difference between NFPOs in the private sector and those NFPOs in the public sector that do follow the PS 4200 series, until such time as changes are made to the PS 4200 series in the PSA Handbook.

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

16 Section 4441 retains the current requirements for works of art, historical treasures and similar items not part of a collection. However, such assets that are accounted for as tangible capital assets are subject to the componentization requirements to the extent relevant. In addition, when such assets are accounted for in accordance with Sections 4433 and 4434, they will be written down to reflect partial impairments. The AcSB recognized the additional costs to preparers of applying the guidance related to componentization and assessing and calculating partial impairments, including the costs of getting this information audited. However, the Board received feedback that componentization

and partial impairments are infrequent. Considering the cost of applying this guidance, the Board ultimately thought the usefulness of information provided by the componentization of assets and recognition of partial impairments outweighed the costs associated with preparing it.

17 There will continue to be a lack of comparability between NFPOs in the private sector and NFPOs in the public sector that do not use the PS 4200 series in the PSA Handbook until the accounting for works of art, historical treasures and similar items not part of a collection by all public sector entities is addressed in the PSA Handbook. Currently, these types of assets are not recognized in the public sector for those NFPOs following the PSA Handbook without the PS 4200 series. There will also be a lack of comparability created between NFPOs in the private sector and NFPOs in the public sector that do follow the PSA Handbook with the PS 4200 series in regard to the proposals to componentize and recognize partial impairments of works of art and historical treasures not part of a collection.

Collections

18 Stakeholders informed the AcSB that there was diversity in practice in the accounting for collections by NFPOs. Some collections were not recorded and others were recorded at nominal value, cost or on another basis. A primary effect of Section 4441 to require collections be recorded at cost or nominal value will be to reduce this diversity. The Advisory Committee and stakeholders informed the Board that Section 4441 will also increase consistency in the recognition of collections since NFPOs will, at a minimum, need to record their collections at nominal value. Consistency benefits users of NFPO financial statements because when economically similar items are accounted for the same way by various NFPOs, it makes the financial statements of different NFPOs more comparable. While NFPOs could choose to recognize collections on their statements of financial position under COLLECTIONS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4440, the Board was informed by the Advisory Committee that many NFPOs did not record them. Therefore, recognizing collections on the face of the statement of financial position will also bring increased awareness to the existence of collections held by NFPOs.

19 The AcSB recognized the costs to preparers of assessing and calculating partial impairments of collections and the costs associated with getting this information audited. However, the Board received feedback from stakeholders that partial impairments are infrequent and usually result from a significant event, such as a fire or flood. Ultimately, while infrequent, the Board thought that the recognizing partial impairments on collections would provide users of the financial statements with useful information and result in consistent accounting treatment for collections and other types of assets.

20 There will continue to be a lack of comparability between NFPOs in the private sector and NFPOs in the public sector that do not use the PS 4200 series in the PSA Handbook until the PSA Handbook provides guidance on the accounting for collections more broadly. The PSA Handbook without the PS 4200 series does not refer to collections, only works of art and historical treasures. For those NFPOs that follow the PSA Handbook without the PS 4200 series, works of art and historical treasures (whether or not part of a collection) are not recognized in the financial statements because a reasonable estimate of the future benefits associated with such property cannot be made. Instead, the existence of such property is disclosed. Additionally, requiring the capitalization of collections at cost or nominal value may create a difference between NFPOs in the private sector and those NFPOs in the public sector that do follow the PS 4200 series. COLLECTIONS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section PS 4240 in the PSA Handbook only requires NFPOs to disclose their collections, although they are not precluded from capitalizing them.

Conclusion on effects analysis

21 Having considered the effects of Sections 4433, 4434 and 4441 discussed above, the AcSB thinks that the positive effects of the new standards outweigh any negative effects and that the new standards will result in significant improvements to financial reporting by NFPOs.

DEVELOPMENT OF THE NEW STANDARDS

22 Throughout the development of the new standards, the AcSB followed its due process. This process included:

(a) ongoing input from the Advisory Committee;

(b) issuance in February 2017 of the Exposure Draft, "Accounting Standards Improvements for Not-for-Profit Organizations";

(c) analysis and consideration of feedback received through written responses to the Exposure Draft (17 comment letters); and

(d) consultations with associates of the Advisory Committee (a diverse group of preparers and practitioners that work in the NFPO sector) and outreach with other NFPO stakeholders.

23 Respondents to the Exposure Draft comprised preparers, including one national umbrella organization for the charitable and non-profit sector, a technical working group on NFPO standards and public accounting firms. The AcSB reminds stakeholders that as part of its due process related to Part III, it makes available a public file of materials relating to completed projects, which includes response letters received, unless confidentiality is requested.

24 Respondents, including participants at meetings, generally supported the underlying principles in the Exposure Draft. However, some respondents provided additional comments suggesting changes to some of the proposals.

25 The specific issues addressed in this project, including the substantive comments received on the Exposure Draft and any changes made in response to those comments, are set out in this document.

TANGIBLE CAPITAL ASSETS AND INTANGIBLE ASSETS

Removing redundancies between Parts II and III of the Handbook

26 Part III is applicable only to private sector NFPOs. NFPOs applying Part III also apply the standards in Part II to the extent that the Part II standards address topics not addressed in Part III.

27 The standards in Part II have been developed with the needs of the financial statement users in mind. The AcSB thinks that financial reporting would be improved if standards in the 4400 series did not simply reproduce, interpret or explain standards otherwise contained in Part II. The Board continues to support directing NFPOs to the same financial reporting standards followed by private enterprises when those standards apply to circumstances and transactions that are common to all entities in the private sector. Such an approach has resulted in more consistent financial statement reporting within the private sector, as well as those financial statements being more readily understood by users.

28 Under TANGIBLE CAPITAL ASSETS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4431, the accounting requirements regarding the capitalization, amortization and disposal of tangible capital assets were either identical, or substantially similar, to the requirements of PROPERTY, PLANT AND EQUIPMENT, Section 3061 in Part II. Therefore, Section 4433 removed the redundancies between Parts II and III by not including guidance that duplicates Section 3061 in Part II. The AcSB noted that any guidance in Section 4431, or INTANGIBLE ASSETS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4432, that was unique to Part III (e.g., material related to contributed assets) was included in Sections 4433 and 4434. Respondents generally agreed that NFPOs should be directed to follow Part II for tangible capital assets and intangible assets, except for the guidance specific to NFPOs set out in Sections 4433 and 4434. The AcSB also added guidance to Section 4433 to clarify what is included in the cost of a contributed tangible capital asset.

Amortization of tangible capital assets

29 To avoid redundancies, the AcSB proposed in the Exposure Draft to exclude amortization guidance from Section 4433 and, consequently, NFPOs would apply PROPERTY, PLANT AND EQUIPMENT, Section 3061 in Part II, for guidance on amortizing all tangible capital assets, including contributed capital assets. Paragraph 3061.16 in Part II, states that amortization of capital assets is the greater of cost less residual value over the asset's estimated useful life and cost less salvage value over the life of the asset. TANGIBLE CAPITAL ASSETS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, paragraph 4431.16, stated that amortization of capital assets is based on "cost less residual value" and is provided over the asset's estimated "useful life" in a rational and systematic manner, which differs from the guidance in Section 3061 in Part II. Therefore, excluding amortization guidance from Section 4433 meant that NFPOs would apply paragraph 3061.16 in Part II, which may result in a change in practice on initial application of Section 4433.

30 The AcSB was informed by the Advisory Committee that it did not foresee any issues with the amortization requirements in PROPERTY, PLANT AND EQUIPMENT, Section 3061 in Part II, because salvage values are likely nominal or less than residual value and, therefore, would not likely result in a change in practice. Consequently, the Board decided to exclude amortization guidance from Section 4433.

Componentization

31 The AcSB recognized that by directing NFPOs to follow PROPERTY, PLANT AND EQUIPMENT, Section 3061 in Part II, NFPOs need to consider the guidance related to componentization, which was not included in TANGIBLE CAPITAL ASSETS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4431. The Advisory Committee noted that NFPOs generally do not have unique characteristics compared to other entities when accounting for components of tangible capital assets. The Board agreed with the Advisory Committee, and ultimately did not identify any reasons why NFPOs should be different from other entities and not be required to consider componentization.

32 Many respondents noted no issues unique to NFPOs regarding the componentization of tangible capital assets. However, some respondents thought that NFPOs should not be required to consider componentization, citing concerns around the cost to apply the requirement exceeding the benefits, particularly for NFPOs with significant resource constraints and lack of internal expertise. Further, one respondent suggested that unlike private enterprises, componentization will not provide decision-useful information to users of NFPO financial statements because NFPOs do not typically make decisions around the replacement of assets based on whether assets are fully amortized. The AcSB considered this feedback and concluded that no compelling differences between NFPOs and private enterprises were identified that would justify NFPOs not applying the componentization requirements in Part II.

Recognizing partial impairments of tangible capital assets and intangible assets

33 The AcSB decided that NFPOs should be required to recognize partial declines in the value of tangible capital assets and intangible assets when conditions indicate that the asset is impaired. The Board noted that the need to recognize partial impairments is common among all types of entities and did not identify any unique circumstances for NFPOs that warrant different accounting. The Advisory Committee advised the Board that partial impairments for NFPOs would likely be infrequent as they generally would apply to buildings and usually result from redundancies or damage. For example, an impairment of an asset may have occurred when 25 percent of a building is no longer being used by the NFPO. The majority of respondents to the Statement of Principles agreed with recognizing partial impairments of tangible capital assets and intangible assets. These respondents also agreed that although an asset may no longer be working at its full potential, it still has value to the organization.

34 In developing Sections 4433 and 4434, one option the AcSB considered for recognizing write-downs of tangible capital assets and intangible assets was to direct NFPOs to Part II. However, the Advisory Committee expressed concerns to the Board that in IMPAIRMENT OF LONG-LIVED ASSETS, Section 3063 in Part II, recoverability of the carrying amount of an asset relates to future cash flows expected to result from the asset's use and disposal. Paragraph 3063.05 in Part II states: "The carrying amount of a long-lived asset is not recoverable if the carrying amount exceeds the sum of the undiscounted cash flows expected to result from its use and eventual disposition."

35 The Advisory Committee informed the AcSB that NFPOs likely hold tangible capital assets and intangible assets whose future economic benefits or service potential are not directly related to their ability to generate cash flows. Instead, the future economic benefits or service potential may be based on the amount the organization would need to pay to acquire the economic benefits or service potential to achieve its objectives and not on recoverability of expected future cash flows. Consequently, the Board decided that guidance be added to Sections 4433 and 4434 for recognizing write-downs of tangible capital assets and intangible assets, instead of directing NFPOs to Part II.

36 Most respondents agreed that NFPOs should be required to recognize partial write-downs of tangible capital assets and intangible assets. However, some respondents raised concerns that future economic benefits are not a relevant consideration for NFPOs when assessing whether tangible capital assets or intangible assets may be impaired. The Advisory Committee noted that while future economic benefits, which typically focus on future cash flows, are not a relevant consideration for all NFPOs, there are many scenarios when they would be relevant. The AcSB considered the advice from the Advisory Committee and decided that no changes were necessary. In reaching this conclusion, the Board also observed that in assessing the future economic benefits of an asset, NFPOs could include a broad range of considerations, including the societal benefit provided by the asset. Further, if future economic benefit is not relevant, the guidance notes that NFPOs may alternatively consider the service potential of an asset.

37 Some respondents interpreted the proposals to require NFPOs to measure annually the amount the organization would need to pay to acquire the future economic benefits or service potential when assessing whether an impairment exists. The AcSB noted that the guidance only states that an NFPO needs to consider whether an asset is impaired by assessing whether any indicators of impairment exist. Measurement of fair value or replacement cost is only required if an NFPO determines that an asset may be impaired. The Advisory Committee agreed with stakeholders that the wording in the Exposure Draft proposals may be confusing and suggested changes to the amendments to clarify the requirements. Considering the advice from the Advisory Committee and the feedback from respondents, the Board decided to clarify the guidance on identifying impairments.

38 One respondent observed that the proposals required that the impairment test be applied individually for each tangible capital asset or intangible asset. The respondent thought that this could be more onerous than the equivalent test for private enterprises in IMPAIRMENT OF LONG-LIVED ASSETS, Section 3063 in Part II, which allows assets to be grouped for purposes of impairment. Considering this feedback, the AcSB decided to amend the guidance to allow the grouping of assets for impairment testing purposes. Assets may be grouped when they are integrated with one another such that an organization must consider the future economic benefits or service potential of the group of assets as a whole rather than at the individual asset level. For example, assets might be integrated when they are used together to generate future economic benefits or service potential. NFPOs must use judgment to determine when assets are integrated and should be grouped.

Indicators of impairment

39 The AcSB decided to include a list of conditions in Sections 4433 and 4434 that may indicate that a write-down of tangible capital assets and intangible assets is appropriate, similar to the list provided in IMPAIRMENT OF LONG-LIVED ASSETS, Section 3063 in Part II. In developing the Exposure Draft, the Advisory Committee noted that a decrease in service potential would be a common scenario for NFPOs as to when a write-down of an asset may be necessary. Therefore, the Advisory Committee suggested that an example of a condition demonstrating this scenario should also be added to the list of indicators. Considering the Advisory Committee's input, the Board proposed to include a list consistent with the list in Section 3063 in Part II, with the addition of an indicator regarding a decrease in the need for the services provided by the asset as an example of a condition that may indicate a decrease in service potential. The Board acknowledged that this is just one possible example of a condition indicating a decrease in service potential.

40 Most respondents thought that the list of indicators was helpful and supported the list proposed in the Exposure Draft. However, some respondents raised a concern regarding some of the proposed indicators. A few respondents were not supportive of using the same indicators as in IMPAIRMENT OF LONG-LIVED ASSETS, Section 3063 in Part II, noting that some indicators relevant for private enterprises are not relevant for NFPOs. The AcSB discussed differences between NFPOs and for-profit enterprises, such as the operating environment, mandate, resources and processes. In particular, the Board considered concerns raised by respondents on inclusion of "costs in excess of the amount originally expected for its acquisition or construction" as an indicator. Respondents had suggested that for many NFPOs, budgeting processes are not sophisticated and increases in the scope of construction projects commonly result in costs exceeding the amount originally budgeted. In considering this issue, the Board emphasized that this indicator specifically refers to costs that are significantly in excess of what was originally expected, and further noted that a change in project scope or an imprecise budget alone would not indicate the asset is impaired. Ultimately, the Board did not identify any factors that would suggest that the list of examples of indicators of impairment in Part III should be

different than Section 3063 in Part II, apart from the addition of an example condition demonstrating a decline in service potential, and therefore the list of indicators was finalized as exposed.

41 The AcSB noted that the list of indicators is intended to provide examples of conditions that may be present to indicate impairment. The list is not meant to be a checklist nor is it an all-inclusive list of indicators of impairment. An NFPO may find that one of the example indicators of impairment exists as well as other evidence contrary to the indicator, and determine that the asset is not impaired. The Board also discussed whether the list of indicators should be segregated into different types (e.g., primary versus secondary indicators or external factor versus internal factor indicators). However, the Board did not want to add unnecessary complexity for NFPOs and, therefore, did not segregate the list of indicators in Sections 4433 and 4434.

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

42 Occasionally, an NFPO may acquire works of art, historical treasures and similar items to be used as tangible capital assets or for sale. For example, the organization may acquire a work of art to be used as an office furnishing or receive a work of art that will be sold. Prior to being replaced, COLLECTIONS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, paragraph 4440.02, stated: "Works of art, historical treasures and similar items that are not part of a collection are dealt with in TANGIBLE CAPITAL ASSETS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4431, and INTANGIBLE ASSETS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4432."

43 The AcSB noted that at the time COLLECTIONS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4440, was developed, INVENTORIES HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 3032, did not exist. Therefore, for completeness, the Statement of Principles proposed to add a reference to Section 3032 in paragraph 4440.02. The proposal was to allow works of art, historical treasures and similar items to be accounted for according to their intended use (i.e., as capital assets or inventory items). Statement of Principles respondents agreed with the proposal and did not express any concerns.

44 However, during the development of the Exposure Draft, the Advisory Committee expressed concerns to the AcSB with adding a reference to INVENTORIES HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 3032, since it may signal a change in practice, which was not the Board's intent. In considering the Advisory Committee's input, the Board noted that paragraph 4441.02 does not require using a specific section. Instead, the paragraph identifies guidance that may be applicable to works of art, historical treasures, etc. not part of a collection. The Advisory Committee informed the Board they are not aware of any NFPOs that account for works of art, etc. as inventories. Instead, they are either tangible capital assets, intangible assets or investments, so TANGIBLE CAPITAL ASSETS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4431, INTANGIBLE ASSETS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4432, or INVESTMENTS, Section 3051 in Part II, are applied. However, some respondents to the Exposure Draft noted there are NFPOs who account for rare works of art, etc. as inventories. Therefore, the Board decided to allow these items to continue to be accounted for as tangible capital assets, intangible assets, investments or as inventory type items depending on their intended use (i.e., in accordance with Sections 3032, 3051, 4433 or 4434).

45 The AcSB decided that the guidance in TANGIBLE CAPITAL ASSETS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4431, relating to land not being amortized would be excluded from Section 4433 because it duplicates the guidance in PROPERTY, PLANT AND EQUIPMENT, Section 3061 in Part II. The Board also decided that the requirement in Sections 4433 and 4434 to recognize partial impairments of tangible capital assets and intangible assets means that works of art, historical treasures and similar items that are not part of a collection and are accounted for as tangible capital assets or intangible assets would be written down to reflect partial impairments.

Measuring partial impairments of tangible capital assets and intangible assets

46 The AcSB, considering the input from the Advisory Committee, assessed various options for measuring the impairment of tangible capital assets and intangible assets. The Board recognized that NFPOs have experience determining fair value (e.g., contributed capital assets are initially measured at fair value). However, the Advisory Committee informed the Board that determining fair value would be difficult, and in some cases impracticable, for many NFPOs. For many assets, NFPOs do not intend to sell them and some assets do not have readily available market values. The Advisory Committee also noted that in many cases determining fair value would be costly because an appraisal would be needed and auditors would need to verify the amount. Consequently, the Board recognized the importance of giving NFPOs an alternative if fair value was required, particularly for situations when determining fair value would be too costly or when there are no readily available market prices for the asset.

47 After considering other alternatives, the AcSB decided that a choice of replacement cost and fair value would be the most appropriate because it would provide clear parameters on the value to which an asset should be written down. It also provides NFPOs the flexibility to choose the amount that is readily available and at a lower cost. The Board observed that, like fair value, NFPOs are familiar with using replacement cost (e.g., inventories are measured at the lower of cost and current replacement cost). Therefore, the AcSB decided that an asset should be written down to its replacement cost or fair value.

48 Most respondents agreed with the option to write an asset down to its replacement cost or fair value. However, some respondents indicated that the Exposure Draft was unclear as to whether an NFPO has the choice to measure an impairment using either fair value or replacement cost, and whether this is an accounting policy choice that must be

applied to all assets. The AcSB's intention was to allow NFPOs to choose fair value or replacement cost on an asset-by-asset basis to measure the write-down of an asset, based on whichever value is most relevant or readily determined. Based on this feedback, the Board decided to clarify this aspect of Sections 4433 and 4434 in the final standards.

Presentation and disclosure

49 The Advisory Committee informed the AcSB that the disclosure requirements in IMPAIRMENT OF LONG-LIVED ASSETS, Section 3063 in Part II, relating to impairment would be useful to users of NFPO financial statements. Consequently, the Board decided that Sections 4433 and 4434 direct NFPOs to follow the disclosure requirements in Section 3063 in Part II for impairments of tangible capital assets and intangible assets. The Board also decided that a disclosure requirement be added to Sections 4433 and 4434 to describe whether the impairment is measured at the asset's replacement cost or fair value.

Transition

50 The AcSB discussed that in the absence of specific transitional provisions, ACCOUNTING CHANGES, Section 1506 in Part II, requires amendments to be applied retrospectively, except if it is impracticable. The Advisory Committee informed the Board that retrospectively calculating partial impairments for all tangible capital assets and intangible assets of an NFPO and retrospectively separating tangible capital assets from their component parts could, in many cases, be impracticable. Therefore, by using the impracticable exception, some members of the Advisory Committee thought that Section 1506 in Part II would permit prospective application.

51 The AcSB noted the challenges of using the impracticable exception in ACCOUNTING CHANGES, Section 1506 in Part II, and thought that retrospectively calculating partial impairments and separating tangible capital assets from their component parts could be onerous, subjective and require the use of hindsight. Therefore, the Board decided that Sections 4433 and 4434 be applied prospectively.

52 The AcSB also recognized that since componentization of tangible capital assets can provide useful information, as discussed in paragraph 12 above, some NFPOs may want to apply the requirements in PROPERTY, PLANT AND EQUIPMENT, Section 3061 in Part II, retrospectively. However, the Board acknowledged that organizations may face challenges in determining the amounts to allocate to the component parts retrospectively. Therefore, the Board decided to permit NFPOs on initial application of Section 4433 to allocate the costs of tangible capital assets to their component parts based on:

(a) their cost or fair value at the date of acquisition; or

(b) their fair value or replacement cost at the date of application of Section 4433.

This exception allows for the allocation of the net book value of an organization's existing tangible capital assets to their component parts at the date Section 4433 is first applied without full retrospective application of componentization. As a result, comparative amounts would not be restated for the effects of componentization.

53 The AcSB also recognized that some NFPOs may have the information to calculate the partial impairments of their assets, and these NFPOs may want to reflect the cumulative amount of these impairments at the date Sections 4433 and 4434 are first applied. Consequently, the Board decided to include transitional provisions that permit an NFPO on initial application of Sections 4433 and 4434 to reflect, as a cumulative adjustment to opening net assets, all partial impairments existing at that date. This prevents an NFPO from having to recognize in its statement of operations in the current period partial impairments that occurred prior to the date of applying Sections 4433 and 4434. This represents a departure from full prospective application of Sections 4433 and 4434.

54 The AcSB also decided that an NFPO can only apply the transition provisions as described above to its annual financial statements relating to the first fiscal year in which Sections 4433 and 4434 are effective.

COLLECTIONS

Nature of collections

55 Collections can include a vast array of items such as paintings, writings, sculptures, artifacts, specimens, land and buildings. Prior to being replaced, COLLECTIONS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, paragraph 4440.04, noted that although items meeting the definition of a collection exhibit the characteristics of assets, set out in FINANCIAL STATEMENT CONCEPTS FOR NOT-FOR-PROFIT ORGANIZATIONS, Section 1001, they are not considered capital assets because of their nature. An organization must protect and preserve the collection in perpetuity and any proceeds from the sale of collection items must be used to acquire additional items or for the direct care of the remaining collection. Historically, it is the existence of these unique attributes that has distinguished collections from capital assets and resulted in unique accounting requirements for collections. One could argue that the organization is simply a custodian of the collection items in order to protect and preserve them for public exhibition, education or research.

56 In developing Section 4441, the AcSB was aware that in some jurisdictions 1 works of art, historical treasures and other items that are part of a collection are called heritage assets and are accounted for the same as other assets. 2 However, the Board was also aware that in the United States (U.S.) there are specific requirements for items that meet the definition of a collection. 3 In the U.S., NFPOs are encouraged to capitalize their collections. However, if collections are not capitalized, there are additional disclosure requirements. Therefore, consistent with the U.S., the Board decided that collections should be accounted for based on their unique nature. The Board noted that when items do not or no

longer meet the definition of a collection, they should be accounted for in accordance with INVENTORIES HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 3032, INVESTMENTS, Section 3051 in Part II, Section 4433 or Section 4434. If an NFPO does not have, or no longer has, an organizational policy that requires any proceeds from the sale of collection items to be used to acquire additional items or for the direct care of the remaining collection, Section 4441 would not apply.

Initial recognition and measurement

57 COLLECTIONS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4440, was a disclosure standard and consequently did not address the recognition of collections held by NFPOs. As a result, practice with respect to recognition and measurement of collections held by NFPOs varied. Some collections were not recorded, and some were recorded at nominal value, cost or another basis. Therefore, the AcSB decided that Section 4441 would require collections be recorded at cost or nominal value to bring more consistency and comparability to the reporting of collections. Also, requiring an NFPO to, at a minimum, recognize its collections at nominal value in the statement of financial position is meant to highlight the existence of the collection. Historically, without such a requirement the existence of a collection may have only been evident in the financial statement notes.

58 As part of developing Section 4441, the AcSB consulted various stakeholders who hold different types of collections (e.g., art galleries, museums and universities). Stakeholders informed the Board that the historical cost of collections is not necessarily reflective of the current market value of, or the benefits to be received from, collections. Further, while the market value of some collections may be readily determined, any attempt to ascertain current market values for many collections may be impracticable or the costs would exceed the benefits of doing so. Therefore, the Board decided that if collections are required to be recognized, an accounting policy choice with an alternative to account for the collections at cost would be needed. Providing this choice would allow NFPOs to take cost / benefit considerations into account, while still providing useful information to users about the existence of a collection.

59 As an alternative to measuring collections at cost, the AcSB decided to provide an option to recognize collections at nominal value. This option gives a collection as much prominence on the statement of financial position as other assets and would accommodate situations when the cost of a collection is unknown or difficult to measure. Although recognizing a nominal value may seem immaterial to some NFPOs, the Board noted that the importance of collections to an NFPO may have qualitative as well as quantitative considerations that must be taken into account when considering materiality. For example, recognizing collections would highlight to users of an NFPO's financial statements assets that may be key to carrying out and achieving its objectives.

60 In reaching the decision to provide an option to recognize collections at either cost or nominal value, the AcSB discussed various other options to highlight the existence of collections to users. Options included a note disclosure, or a note reference on the statement of financial position similar to a leases commitments note (i.e., Note X Collections). Through outreach with stakeholders, users emphasized to the Board the importance of highlighting the existence of the collections on the face of the statement of financial position, rather than disclosure in the notes. Further, the stakeholders informed the Board that putting a note reference on the statement of financial position may send a message that the collections have no value, which is not the case; the value is simply unknown. Therefore, the Board concluded that the other options considered were not appropriate.

61 The AcSB also discussed whether the choice of recording collections at cost or nominal value should be an accounting policy choice that would be applied to all of an NFPO's collections, versus allowing a different policy choice for each collection. The Advisory Committee informed the Board that consistency within the financial statements of an NFPO in accounting for its collections is important and applying the same accounting policy choice to all of an NFPO's collections would provide more useful information to users. However, the Advisory Committee also cautioned the Board that requiring the same policy choice to be applied for all collections may deter NFPOs from using cost. For example, if an NFPO has two collections (i.e., one for which cost is determinable, and another for which cost cannot reasonably be determined), the NFPO would have to choose to record both collections at nominal value. This choice could prevent the NFPO from continuing to record one collection at cost.

62 During the development of the Exposure Draft, through consultation with the Advisory Committee and other stakeholders, the AcSB was not made aware of situations when an NFPO has multiple collections that are measured differently. Stakeholders had indicated that for most NFPOs, all items were considered part of one collection, or they chose the same policy for all of their collections. Therefore, in the Exposure Draft, Board proposed that the requirement to record collections at either cost or nominal value should be an accounting policy choice that is applied by an NFPO to all of its collections.

63 The AcSB sought input from Exposure Draft respondents on whether NFPOs with multiple collections should be permitted to measure each collection differently. Feedback from respondents was consistent with the Advisory Committee's input, with some respondents supporting one accounting policy being applied to all collections, and others suggesting there is a need to be able to measure each collection differently. The Exposure Draft proposals included an exception that permitted an NFPO that chooses to account for its collections at cost to measure an item in the collection at a nominal value when cost cannot be reasonably determined for that item. Therefore, to address the concern raised by respondents, the Board decided to amend the proposals in Section 4441 to expand this exception to include, for an NFPO with multiple collections, a collection when the cost for that collection cannot be reasonably determined. The

Board noted that this would generally result in consistency within financial statements, as NFPOs would still be required to make an accounting policy choice and apply it to collections. Further, the Board thinks that measuring collections at cost provides more useful information to users. Therefore, the expanded exception encourages NFPOs to select cost as their accounting policy for collections, even if they have one collection that they are unable to value.

64 The AcSB also considered disclosure requirements for NFPOs that apply this exception, and decided to include a requirement in Section 4441 for an NFPO that selects cost as its accounting policy to disclose information about any items or collections measured at a nominal value.

65 The Advisory Committee informed the AcSB that guidance for determining cost, including a description of what is included in the cost of a collection, would be useful to NFPOs. Therefore, the Board decided to specify in Section 4441 that the cost of a collection, in addition to the purchase price of acquired items or the fair value of contributed items, also includes all other costs directly attributable to acquiring the items in the collection (e.g., installation costs and transportation costs). This definition of cost was derived from PROPERTY, PLANT AND EQUIPMENT, Section 3061 of Part II, and was refined to reflect the specific nature of collections. The Board also decided to clarify that the cost incurred in protecting and preserving the items in collections is a repair or maintenance activity and should be expensed.

66 In addition, consistent with the guidance included in Section 4433, the AcSB decided that Section 4441 would specify that when an item is purchased by an NFPO at substantially below fair value, the item would be recognized at its fair value, with the difference between the consideration paid and the fair value reported as a contribution.

Amortization

67 In Parts II and III, for assets with limited lives subsequent to initial recognition, an organization must amortize its assets over their useful life, which is defined as the period over which an asset is expected to be used by an organization. However, for assets with unlimited lives, amortization is not required. Since the nature of collections requires an organization to protect and preserve these assets in perpetuity, the assets have an unlimited life and, therefore, amortization is not required. This treatment is consistent with how other types of assets are accounted for that have unlimited lives (e.g., land and some intangible assets). Therefore, the Board decided that Section 4441 should specify that amortization is not required.

Partial impairments of collections

68 For collections recorded at cost, the AcSB decided that they be written down whenever events or changes in circumstances indicate that the net carrying amount of the collection or collection item exceeds its replacement cost or fair value. This decision considered input from the Advisory Committee, which informed the Board that it did not see a reason why collections would not be written down, consistent with the proposals for tangible capital assets, intangible assets and works of art, historical treasures and similar items not part of a collection (i.e., so that the value of the assets are not overstated). Based on input from the Advisory Committee, the Board thought that write-downs of collections would be rare (e.g., when the write-downs are the result of a significant event, such as a fire or a flood, in which case the amount and timing of the impairment would be known). The Board also decided that, consistent with the proposals for Sections 4433 and 4434, examples of conditions that may indicate that a write-down is appropriate would be included in Section 4441.

Disposals

69 The AcSB notes that in accordance with the definition of a collection in Section 4441, an NFPO is required to use all proceeds from the sale of one or more items of a collection to purchase other items in the collection or care for existing items. Since COLLECTIONS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4440, did not contain guidance on accounting for disposal of collection items, in replacing this standard with Section 4441, the Board thought that it would be helpful to include guidance that specifies how to account for the gains and losses on such disposals. Therefore, in the Exposure Draft, the Board proposed to add guidance to Section 4441 requiring the gain or loss on disposal of contributed collection items that have external restrictions to be accounted for in accordance with CONTRIBUTIONS — REVENUE RECOGNITION, Section 4410. However, for items in a collection that do not have external restrictions and are disposed of, the gain or loss would be recognized in the statement of operations.

70 Most respondents agreed that NFPOs should be directed to account for the gain or loss on disposal of contributed collection items that have external restrictions to be accounted for in accordance with CONTRIBUTIONS — REVENUE RECOGNITION, Section 4410. However, some respondents raised concerns with directing NFPOs to Section 4410, noting it was not clear what guidance in that Section an NFPO would apply. As a result, Section 4441 would not resolve the current diversity in practice regarding disposals of contributed collection items that have external restrictions. Some of these respondents suggested it would be more helpful to provide specific guidance in Section 4441 on how to treat the gain or loss.

71 The Advisory Committee noted that directing NFPOs to account for disposals of collection items that have external restrictions in accordance with CONTRIBUTIONS — REVENUE RECOGNITION, Section 4410, would allow NFPOs to continue to apply their existing accounting policies for disposals and therefore would be simpler to implement as there would be no change in practice. Furthermore, the Advisory Committee observed that disposal of items in a collection is quite rare in practice. Considering the input from the Advisory Committee, the AcSB decided not to make any changes. The Board noted that this approach will not resolve the existing diversity in practice

regarding the disposal of contributed collection items that have external restrictions; however, addressing diversity in the application of Section 4410 would be outside of the scope of this project. The Board has a project on Contributions on its work plan, which may result in changes to Section 4410 at a later date. Therefore, the Board will consider the concerns regarding diversity and whether clarifications to the treatment of disposals of collections should be made through the Contributions project.

72 Some respondents also noted that, while they agreed with directing NFPOs to account for a gain on disposal of items in a collection that have external restrictions in accordance with CONTRIBUTIONS — REVENUE RECOGNITION, Section 4410, the AcSB should consider whether this is appropriate treatment for a loss. The Board discussed this issue, and decided to change the guidance in the final standard so losses are recognized in the statement of operations.

73 The AcSB noted that COLLECTIONS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4440, contained additional disclosure requirements relating to proceeds from the sale of collection items that are useful and therefore decided to include these disclosures in Section 4441. In developing the Exposure Draft, the Board also noted that CASH FLOW STATEMENT, Section 1540 in Part II, requires that an NFPO should disclose the amount of cash when its use is restricted. Therefore, the Board sought feedback from Exposure Draft respondents on whether the application of the disclosure guidance in the Exposure Draft and Section 1540 in Part II would highlight that the proceeds not yet spent from the sale of collection items are restricted.

74 Respondents had mixed views, with a number of respondents indicating that the interpretation of what is considered restricted under CASH FLOW STATEMENT, Section 1540 in Part II, varies. Therefore, some NFPOs may not disclose proceeds not yet spent from disposals of a collection as restricted cash. Other respondents also noted that relying on the disclosure requirements of CASH FLOW STATEMENT, Section 1540 in Part II, would not capture non-cash proceeds (e.g., receivables or other contributed assets). Accordingly, the AcSB decided to add disclosure requirements in Section 4441 to require an NFPO to disclose the total proceeds not yet spent from the disposal of a collection at the end of the reporting period, including cash and other assets. Further, the Board noted that addressing the interpretation issues raised by respondents regarding the restricted cash disclosures in Section 1540 in Part II would be outside the scope of this project. However, the Board may consider undertaking a project to address this diversity at a later date.

Presentation and disclosures

75 The Advisory Committee informed the AcSB that the disclosure requirements in COLLECTIONS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4440, were working well in practice. Consequently, the Board decided to include the disclosures from Section 4440 in Section 4441. In addition, the Board decided to add a requirement that the amount recognized for collections would be presented on a separate line in the statement of financial position. Presenting collections on a separate line would achieve the objective of highlighting the existence of the organization's collections to users. The Board also decided that, consistent with IMPAIRMENT OF LONG-LIVED ASSETS, Section 3063 in Part II, disclosure requirements for the write-down of collections would also be added to Section 4441 since this information is also useful to users.

Transition

76 The AcSB noted that in the absence of specific transitional provisions, ACCOUNTING CHANGES, Section 1506 in Part II, requires amendments to be applied retrospectively, except if it is impracticable. The Board thought that retrospective application would be useful since it would provide comparable information with the prior year. However, the Board recognized the challenges in retrospectively applying the proposals for those NFPOs that choose to record their collections at cost, particularly with measuring items in a collection that were acquired in previous periods.

77 The AcSB thought it was important to make the transition to cost easier since recognizing collections at cost results in more useful information to financial statement users. Consequently, the Board decided to provide relief from full retrospective application for NFPOs that choose to recognize their collections at cost. An NFPO can only use this relief in the year when it first applies Section 4441. These NFPOs are permitted to capitalize retrospectively the items in a collection acquired in previous periods using either: cost or fair value at the date of acquisition; or fair value or replacement cost at the date of adoption of Section 4441. The Board is also aware there could be situations when the cost of one or more items in a collection, or for an organization with multiple collections, an entire collection, cannot be reasonably determined and, therefore, decided that those can be recorded at nominal value. In these situations, the Board notes that recording an item or collection at nominal value does not preclude the remaining items in the collection or other collections from being recorded at cost.

78 Consistent with the proposals for tangible capital assets and intangible assets, the AcSB recognized that some NFPOs would have the information to determine the partial impairments of their collections and may want to reflect the cumulative amount of these impairments at the date of application of Section 4441. Consequently, on initial application of Section 4441, the Board decided to permit an NFPO to reflect, as a cumulative adjustment to opening net assets, all partial impairments existing at that date. This prevents an NFPO from having to recognize in its statement of operations in the current year, partial impairments that occurred prior to the date of application of Section 4441.

79 Consistent with the proposals for tangible capital assets and intangible assets, the AcSB decided that an NFPO can only apply the transitional provisions as described above to its annual financial statements relating to the first fiscal year in which Section 4441 is effective.

EFFECTIVE DATE

80 The Exposure Draft proposed that Sections 4433, 4434 and 4441 be effective for annual financial statements beginning on or after January 1, 2019, with earlier application permitted. Most respondents agreed with the proposed effective date and, accordingly, the AcSB finalized the effective date as proposed.

81 Given that many NFPOs have March 31 fiscal year-ends, the Exposure Draft also asked stakeholders whether it would be preferable to have the effective date of April 1 for this and future Part III proposals. While some respondents were in favour of an April 1 effective date, most respondents indicated that January 1 is preferable, such that new Part III standards and amendments align with the effective dates for new Part II standards and amendments, since NFPOs must apply both parts of the Handbook.

CONSEQUENTIAL AMENDMENT

82 The final standards include a consequential amendment to FIRST-TIME ADOPTION BY NOT-FOR-PROFIT ORGANIZATIONS, Section 1501. This consequential amendment allows NFPOs to apply the transition provisions in paragraph 4441.24 when applying accounting standards for NFPOs for the first time. Without this provision in Section 1501, first-time adopters would be required to apply Section 4441 retrospectively without any relief, which could lead to many NFPOs choosing nominal value as their accounting policy for collections. The AcSB decided to include this provision in Section 1501 to make it easier for an NFPO to recognize collections at cost when it first adopts accounting standards for not-for-profit organizations, as this results in more useful information to financial statement users.

EXPOSURE FOR COMMENT

83 After resolving the issues arising from the exposure-draft process, the AcSB considered, as part of its due process, whether the revisions to the proposals should be exposed for comment.

84 The revisions included clarifying guidance for recognizing and measuring partial impairments of tangible capital assets and intangible assets, and clarifying the accounting treatment for collections, including the initial recognition of collections at cost and disposal of items in a collection. These clarifications were made based on the feedback received from stakeholders. Other than these clarifications, only minor drafting changes were made. Therefore, the AcSB decided that there was no need for re-exposure. The Board agreed on the revisions discussed above.

Footnotes

1. Such as Australia, New Zealand and the United Kingdom.

2. Except when the value of an item cannot be measured reliably, or measurement is too costly, in which case, only disclosure is required.

3. The definition of a collection in the United States is consistent with Canada.
