Assurance and Accounting

Accounting Standards for Not-For-Profit Organizations (ASNPO) Update 2022

Introduction

It was a busy year for the Accounting Standards Board (AcSB or the Board) and for Part III of the CPA Canada Handbook – Accounting: Accounting Standards for Not-for-Profit Organizations (ASNPO). As organizations continue to adapt to the ever-changing market landscape, the Board was hard at work advancing the progress of various projects, including its projects on accounting for contributions. In addition, a new standard became effective in the current year providing guidance on accounting for combinations of not-for-profit organizations (NPOs). Both of these items will be discussed in this publication.

Private sector NPOs applying ASNPO also apply the relevant standards in Part II of the CPA Canada Handbook – Accounting: Accounting Standards for Private Enterprises (ASPE) to the extent that the standards in Part II address topics applicable for NPOs that are not addressed in Part III. As a result, some changes made to ASPE also affect NPOs. This publication will discuss amendments resulting from the AcSB's projects on revenue and cloud computing arrangements and their impact on NPOs, as well as, provide an update on other projects the AcSB is working on that will impact NPOs in the future.

Standards Effective in 2022

Section 4449, Combinations by Not-for-Profit Organizations

Combinations between not-for-profit organizations ("NPOs") are becoming more frequent. As no guidance on accounting for these types of transactions was previously included in ASNPO, there was diversity in practice. After consultation with stakeholders, the Board issued new Section 4449, *Combinations by Not-for-Profit Organizations*, in March 2021 to provide guidance on accounting for such transactions. The main highlights of the standard include:

Scope

- This Section applies to a combination involving two or more NPOs that are unrelated parties or related parties.
- This Section does not apply to the acquisition of a for-profit enterprise by an NPO, a contribution of a for-profit enterprise to an NPO, a contribution of cash or other assets which do not constitute an NPO to an NPO, or the formation of a joint venture.

Distinguishing between a Merger and an Acquisition

- A combination is a transaction or event involving two or more not-for-profit organizations that is accounted for as either a merger or an acquisition. The accounting treatment for a combination depends on the characteristics of the transaction and whether certain criteria are met.
- Except for a combination of NPO's under common control, which is always accounted for as a merger, a combination is accounted for as a merger when all the following criteria are met:
  - Neither party to the combination is identified as either the acquirer or acquiree;
  - Those charged with governance of the predecessor organizations participate in determining the terms of the combined organization, including establishing the governance and management structures of the combined organization and in selecting management personnel;
  - Except for transaction costs, no significant consideration flows to a third party of the organizations combining;
  - The combined organization encompasses the purposes of each of the NPOs combined at the combination date; and
  - At the combination date, there is no significant decline or planned significant decline in the client communities served by one or more, but not all, of the combining NPOs.
- If any of the above criteria are not met, the combination is accounted for as an acquisition.

Accounting for a Combination as a Merger

- The carrying values of the assets, liabilities and net assets of the combining entities become the combined carrying values of the assets, liabilities, and net assets of the combined organization.
- Where the combining organizations have been applying different accounting policies in their separate financial statements, the combined organization makes adjustments to ensure the accounting policies are uniform in both the current and comparative period.
- Comparative information must be presented showing the combined results as though the organizations had always been combined.

Accounting for a Combination as an Acquisition

- One of the combining entities must be identified as the acquirer using the guidance in Section 4450, *Reporting Controlled or Related Entities by Not-for-Profit Organizations*.
- The reporting entity can choose to either disclose or consolidate its controlled not-for-profit organizations.
- Where the organization chooses to disclose the controlled NPO, it must identify the acquirer, the combination date, and include the disclosures required by Section 4449 and Section 4450.
- Where the organization decides to consolidate, at the combination date the acquirer recognizes the identifiable assets acquired and liabilities assumed and measures them at their acquisition-date fair values, except for certain exceptions to the recognition and/or measurement principles.
- The difference between the acquisition-date fair value of the consideration transferred and the acquisition date amount of the identifiable net assets acquired is recognized and presented separately in the statement of net assets.

Disclosure

- For both a merger and an acquisition, the reporting organization discloses information that enables financial statement users to evaluate the nature and financial effects of the combination.

Section 4449 is effective for fiscal years beginning on or after January 1, 2022 and is applied prospectively. For additional information on this new standard refer to our ASNPO at a Glance: Section 4449 – Combinations by Not-for-Profit Organizations publication.

Significant amendments to Section 3400, Revenue

In 2017, the AcSB issued a survey asking stakeholders for feedback on issues they encountered when applying the guidance in Section 3400, *Revenue*. NPOs follow the guidance in this Section when accounting for revenue transactions that are not within the scope of Section 4410, *Contributions – Revenue Recognition*. As a result of the feedback provided by stakeholders, the Board issued amendments to Section 3400 to provide additional guidance on the following complex areas:

- Identifying the units of account – guidance on how to determine whether an arrangement consists of a group of contracts or a single contract and identifying the units of account in an arrangement;
- Bill-and-hold arrangements – guidance on how to determine if revenue can be recognized when the delivery of the goods or services has yet to occur;
- Multiple-element arrangements – guidance on how to allocate consideration to elements in multiple deliverable arrangements using the relative stand-alone selling price basis, as well as, methods to be used for estimating the stand-alone selling price when not directly observable;
- Percentage of completion method – guidance on how to determine the degree of completion and compute the revenue to be recognized in a period, as well as, additional disclosure requirements for contracts in progress at the end of the reporting period; and
- Reporting revenue gross or net - added additional indicators to aid in determining whether revenue should be recognized on a gross or net basis.

These amendments are effective for fiscal years beginning on or after January 1, 2022 and are to be applied retroactively. However, transitional relief has been provided for certain situations, where an organization would not be required to make retrospective adjustments for long-term contracts accounted for using the percentage of completion method, or when accounting for multiple element arrangements. For additional information refer to our ASPE at a Glance: Section 3400 – Revenue publication.

As part of the above project, the Board also added additional guidance to Section 3400 on when revenue should be recognized for upfront non-refundable fees/payments. However, as organizations started to apply these amendments the Board received feedback from stakeholders, particularly member-benefit organizations, on concerns about the decision-usefulness of deferring upfront non-refundable fees over long membership durations and the costs of applying the amendments. As a result, the Board decided that additional research on these issues was needed. The Board issued an Exposure Draft in July proposing to defer the effective date of the amendments for upfront non-refundable fees/payments to fiscal years beginning on or after January 1, 2025 to give it time to carry out this research. Respondents agreed with the proposals and the Board approved the deferral of the effective date at its September 2022 meeting.

Amendments to Section 3462, Employee Future Benefits

In 2018, Ontario's pension regulator introduced a new reserve, the provision for adverse deviations (PfAD), in the going concern funding valuation for defined benefit plans. This reserve is meant to cover unexpected adverse deviations in such plans. Similarly, in 2016 Quebec enacted Bill 57, which eliminated the requirement to fund a pension plan on a solvency basis.

Instead, plans are funded on a going concern basis with a new requirement to establish a reserve called a stabilization provision, the purpose of which is similar to that of the PfAD. Other Provinces have also introduced similar legislation. Stakeholders raised questions on whether the PfAD and the stabilization provision should be included in the measurement of the defined benefit obligation when an entity makes an accounting policy choice to use a funding valuation under Section 3462, *Employee Future Benefits*, as there was diversity in practice.

As a result, the AcSB amended Section 3462 to clarify the accounting as follows:

When an entity has defined benefit plans without a legislative, regulatory, or contractual requirement to prepare an actuarial valuation for funding purposes, the obligations for these plans are measured using an actuarial valuation prepared for accounting purposes. The previous accounting policy choice to measure such plans on a funding valuation basis has been removed due to the complexities in applying this method and the diversity it caused in practice.

- When an entity has defined benefit plans with a legislative, regulatory or contractual requirement to prepare an actuarial valuation for funding purposes, the obligations for these plans are measured using either an actuarial valuation prepared for accounting purposes or the most recently prepared actuarial valuation prepared for funding purposes provided specific criteria is met.
- When an entity elects to use a funding valuation to measure the defined benefit obligation for defined benefit plans that have a funding valuation requirement:
  - The defined benefit obligation would be measured at the amount that is required to be funded by contributions in accordance with legislative, regulatory, or contractual requirements; and
  - The aggregate of all underlying components of the legislative, regulatory, or contractual requirements would be included in that measurement of the defined benefit obligation (for example the Ontario PfAD and Quebec stabilization provision would be included).

The amendments are effective for fiscal years beginning on or after January 1, 2022 with certain transitional provisions. For additional information refer to our ASPE at a Glance: Section 3462 – Employee Future Benefits publication, as well as, our publication Employee Future Benefits – What you Need to know about Sections 3462 and 3463.

2021 Annual Improvements

The Board has adopted an annual improvement process to amend standards to help clarify guidance/ wording or correct for unintended consequences or conflicts. Any large amendments or the issuance of new standards are outside the scope of this process. During the 2021 annual improvement process, Section 1501, *First Time Adoption by Not-for-Profit Organizations*, was amended to allow organizations that had previously applied ASNPO but whose most recent annual financial statements were not reported under ASNPO, to either apply Section 1501 again upon re-adoption of ASNPO, or to apply the standards retrospectively in accordance with Section 1506, *Accounting Changes*. This amendment is effective for fiscal years beginning on or after January 1, 2022.

Amendments to Section 3856, Financial Instruments

Canada and many jurisdictions across the globe have taken recommendations from the Financial Stability Board's (FSB) report on Reforming Major Interest Rate Benchmarks and are replacing the existing Interbank Offered Rates (IBORs) (for example, the London interbank offered rate (LIBOR), and the Canadian dollar offered rate (CDOR)) with alternative benchmark rates (IBOR reform). As a result of this transition, many debt and derivative contracts that reference these rates will be modified. Section 3856, *Financial Instruments*, requires entities to perform qualitative and quantitative assessments, such as the 10% test, to determine if modifications should be accounted for as extinguishments. For entities with numerous instruments that reference IBOR, this could be very onerous. Also, under Section 3856 a change in the benchmark rate for derivative contracts designated in a hedging relationship would lead to the discontinuation of hedge accounting. These outcomes would not provide financial statements users with useful information.

The Board understood these concerns and issued amendments to Section 3856 to simplify the accounting analysis for debt modifications solely due to IBOR reform, as well as, to allow hedge accounting to continue where there is a change in certain critical terms related to IBOR reform. The main points of the amendments are outlined below:

- Debt Modifications: Entities are given the option to apply a practical expedient to not account for a modification made to one or more contractual terms in an arm's-length debt instrument due to IBOR Reform as an extinguishment, but instead to account for the modification as a continuation of the existing debt instrument. If the practical expedient is applied, it must be applied to all debt instruments that reference IBOR.
- Hedge Accounting: Exceptions to the hedge accounting guidance would apply where critical terms have changed as a direct result of IBOR Reform and as a result the hedging relationship would not be discontinued. The exception would cease being applied once all changes related to the IBOR reform have been made to the hedging and hedged items. The exception would apply to only the following hedging relationships where critical terms are expected to be modified due to IBOR reform:
- An interest-bearing asset or liability hedged with an interest rate swap to mitigate the effect of changes in interest rates; and
  - A foreign currency denominated interest-bearing asset or liability hedged with a cross-currency interest rate swap to mitigate the effect of changes in interest rates and foreign currency exchange rates.

The amendments are effective for fiscal years ending on or after February 1, 2022, and are applied retrospectively, except for certain situations as outlined in Section 3856. Some additional disclosures are required.

Projects on the Go

The AcSB currently has a number of projects in progress that propose future changes that will impact NPOs. The following provides a brief discussion of these projects.

Consultation Paper - Contributions – Revenue Recognition and Related Matters

The AcSB wants to ensure that the guidance on accounting for contributions in Part III of the Handbook is still appropriate. The existing contributions standard has remained largely unchanged since it was established almost 25 years ago. However, research suggests that the landscape for many NPOs has changed over the years and that contribution agreements are becoming more complex. Additionally, the AcSB has heard from users of NPO financial statements that the current accounting policy choice for recognizing contributions (deferral method or restricted fund method) adds complexity to NPO financial statements and creates a lack of comparability among the financial statements of similar NPOs. On the other hand, preparers of NPO financial statements have informed the AcSB that the accounting policy choice accommodates the diverse needs of NPOs and their users and allows individual NPO's to clearly communicate their operations and results.

The Board has undertaken extensive research over the past few years to gain a preliminary understanding of the benefits of, and issues with, the existing contributions guidance. Then in May of 2020, the Board issued a Consultation Paper seeking input from NPO stakeholders, including financial statement users, preparers, and practitioners. The Board reviewed the feedback received on this Consultation Paper and plans to issue an Exposure Draft. At this point, the main proposals the Board is considering for the Exposure Draft include:

- Externally restricted contributions should be deferred and subsequently recognized in revenue when the external restrictions are met. A contribution would be considered externally restricted when the resources are designated for a specific purpose or period and this is explicitly communicated between the organization and the contributor.
- Contributions with external restrictions requiring that the resources be maintained for a specific period should be accounted for like other restricted contributions.
- Capital asset contributions should be deferred and amortized into income over the useful life of the asset.
- Endowment contributions should be recognized as direct increases in net assets in the period in which the organization is entitled to the contribution.
- Organizations can choose to recognize contributed materials and services when their fair value can be reasonably estimated, they are used in the normal course of the organization's operations, and they would have otherwise been purchased.
- Pledges and bequests should not be recognized until the contributed assets are received since an organization cannot control access to the benefit of these contributions until that point.
- Disclosure and presentation requirements.

The Board plans to issue the Exposure Draft in the first quarter of 2023. We would encourage NPOs to stay up to date on this project and respond to the Exposure Draft when it is issued. The latest information on this project is available on the Contributions page of the FRAS Canada website.

Exposure Draft – Customer's Accounting for Cloud Computing Arrangements

Recently, more entities have begun using cloud-computing arrangements to access software. In the past, entities would do an outright purchase of software that would then be physically installed onto their own hardware. In a cloud computing arrangement, customers have the right to use software through remote access whereby the actual software resides on the vendor's hardware. These arrangements contain varying contractual terms and the accounting can be complex, which has led to diversity in practice. There are also concerns that the accounting outcome for implementation expenditures incurred for an arrangement that is a service contract does not reflect the economic benefits an entity receives over time. The AcSB heard stakeholders' concerns, and in March 2022 issued an Exposure Draft proposing the issuance of Accounting Guideline AcG-20, *Customer's Accounting for Cloud Computing Arrangements*, to provide guidance on this topic. The main proposals include:

- Clarification that an entity may determine a method on a rational and consistent basis to allocate the arrangement consideration to the significant separable elements in a cloud computing arrangement;
- Clarification that an entity applies Section 3064, *Goodwill and Intangible Assets*[1], to account for the significant elements in the arrangement, unless the elements are tangible assets or rights to use tangible assets;
- An optional simplification approach to permit an entity to expense as incurred the expenditures related to the elements in a cloud computing arrangement that would fall within the scope of Section 3064;
- For those entities that do not apply the simplification approach, the Guideline provides factors to assist them in applying the control principle in Section 3064 to determine whether the cloud computing arrangement includes a software intangible asset;
- For a software that is a service, there is an accounting policy choice to either:
  - Apply an exception to capitalize directly attributable implementation costs and present these costs as prepaid expenses; or

1. NPO's follow the guidance in Section 4434, Intangible Assets Held by Not-for-Profit Organizations, when accounting for intangible assets. However, Section 4434 only provides guidance on specific items unique to NPOs and refers NPOs to the guidance in Section 3064 for all other items.

- Continue to expense as incurred such implementation costs in accordance with the existing requirements in Section 3064;
- Disclosure requirements to help users understand how the cloud computing arrangement is accounted for in the entity's financial statements; and
- Illustrative examples to assist entities in applying the guidance.

The Board approved the issuance of AcG-20 at its September 2022 meeting and anticipates issuing it in the Handbook in November 2022. AcG-20 will be effective for fiscal years beginning on or after January 1, 2024, with earlier application permitted. The Guideline will be applied retrospectively, with certain transitional relief.

Project – Financial Statement Concepts

In March 2019, the AcSB approved a project to review the financial statement concepts in both Part II and Part III of the CPA Canada Handbook. The project will focus on:

- Elements (definition of an asset, liability, revenue and net assets);
- Recognition;
- Measurement;
- Disclosure; and
- Unit of account

The first items to be addressed will be the definition of an asset and liability. The Board will consider this project while developing its Exposure Draft on Contributions.

Conclusion

As we head closer to the end of the year, now is the time to check in with your BDO advisor about how the changes made to the ASNPO Handbook and the projects on the go will affect your organization. Reach out to us today.