Not-for-Profit Organization Accounting: CICA Re-Exposes Recommendations

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Introduction

In Canada, standard setters have been focusing on the development of accounting standards for not-for-profit organizations over the last decade and a half. The process commenced with a 1980 research study[1] that proposed a uniform set of accounting principles and reporting practices.

Most recently, in December 1993, The Canadian Institute of Chartered Accountants (the "CICA") issued a re-exposure draft (the "Re-Exposure Draft"). It proposes accounting and disclosure standards to establish more complete reporting and greater accountability for not-for-profit organizations. These proposed standards are intended to be consistent with a framework of financial statement concepts adopted by the CICA in 1988[2], which holds that accounting for not-for-profit organizations should be similar to that of profit-oriented entities.

Previously, in January 1992, the CICA issued an Exposure Draft (the "Exposure Draft")[3] which generated nearly 400 responses. Some respondents criticized the Exposure Draft for not sufficiently recognizing the unique characteristics of not-for-profit organizations[4]. Others criticized it for proposing standards that, they claimed, were neither practical nor cost-effective.

The Re-Exposure Draft attempts to address some of the concerns raised by respondents to the Exposure Draft by proposing recommendations that provide certain options in accounting for contributions, capital assets and the reporting entity. In addition, the proposed recommendations are supplemented by enhanced discussion intended to clarify the proposed recommendations and to assist preparers of financial information.

The following is a brief discussion of the Re-Exposure Draft.

Contributions Received

Not-for-profit organizations currently use a variety of revenue- and contribution-recognition policies. The Re-Exposure Draft attempts to establish more uniformity in practice by proposing alternative approaches to accounting for contributions. Organizations would be classified as either reporting on a "restricted fund accounting basis" or not. An organization reports on a "restricted fund accounting basis" when it uses a separate self-balancing set of accounts (or "funds") to segregate its activities and resources according to the specified purposes of donor contributions. Each fund is classified as being for unrestricted, restricted or endowment purposes.

Organizations reporting on a restricted fund accounting basis would recognize contribution revenues in the appropriate fund when received or receivable. Accordingly, fund balances would represent the resources available to be used for the specific purpose of the fund. Externally restricted contributions received, for which an appropriate restricted fund does not exist, would be recognized in accordance with the proposed recommendations for organizations *not* reporting on a restricted fund accounting basis.

An organization *not* reporting on a restricted fund accounting basis would have one fund combining the results of its unrestricted and restricted operations. The Re-Exposure Draft proposes that where externally restricted contributions are received before the related expenses are incurred (i.e., the conditions of the restriction are not fulfilled), the revenue would be deferred for recognition in a subsequent period. Accordingly the fund balance would represent the organization's unencumbered surplus.

In accordance with the foregoing proposals, contributions for capital asset purchases would be recognized as revenues in the appropriate restricted fund, if one exists, or deferred and amortized on the same basis as the related capital asset.

Endowment contributions (that is, restricted contributions requiring that the principal amount thereof be maintained permanently) are recognized as revenue in the endowment fund, if one exists or, alternatively, are credited to the "endowment surplus" account on the balance sheet.

The Re-Exposure Draft proposes that pledges be recognized as an asset receivable if the amount to be received can be reasonably estimated and its ultimate collection is reasonably assured. Pledges receivable may meet these conditions where the organization's experience in fund raising enables it to estimate collectibility. Explanatory material suggests that, given the nature of pledges, few would meet these conditions until pledges are actually received because, typically, there may be insufficient assurance of collectibility.

Contributed materials and services may be recognized in a not-for-profit organization's financial statements provided that (i) a fair value can be reasonably estimated, and (ii) the materials and services are normally used by the organization and would be purchased if they were not contributed.

Capital Assets

Current CICA *Handbook* standards for not-for-profit organizations permit capital asset expenditures to be expensed immediately, capitalized and depreciated, or capitalized but not depreciated, provided that the method used is disclosed.

One of the CICA's objectives is that not-for-profit organizations provide more complete information on their economic resources and economic performance. Accordingly, the Re-Exposure Draft proposes that all capital assets be capitalized and amortized in a rational and systematic manner appropriate to their nature and use by the organization. The balance sheet would then include the amortized cost of capital assets available to the organization and the statement of revenue and expenditures would include a depreciation cost for using available capital assets as part of the total cost of providing its services.

Donated capital assets would be recorded at their fair value, when reasonably determinable, at the date of donation and amortized in the same manner as purchased capital assets.

Recognizing the hardship that these accounting principles could exert on some organizations, the Re-Exposure Draft would provide an exemption from the capital asset standards for "small" organizations, defined as those with total revenues of less than $250,000.

Collections

Museum and gallery collections would not have to be capitalized provided that: (i) they are held for public exhibition, education or research; (ii) they are preserved; and (iii) they are subject to an organizational policy that requires any proceeds from their sale to be used to acquire other items to be added to the collection. As a result of responses received on the Exposure Draft, the CICA concluded that the cost of capitalizing such collections would exceed the benefit of the information gained. However, certain disclosures would be required including a description of the collection and the amount of expenditures on collection items and proceeds from any sales of collection items in the current period.

Reporting of Controlled and Related Entities

Not-for-profit organizations are currently exempt from CICA *Handbook* requirements concerning accounting for subsidiaries and long-term investments so practice varies among them.

The Re-Exposure Draft proposes that an organization could either combine the financial statements of those not-for-profit entities over which it has "control" or provide disclosures of the economic resources and obligations, results of operations and changes in cash flows of those entities. These disclosures are intended to provide information on all resources available to an organization and all the liabilities for which it has responsibility.

Control is defined as "the continuing power to determine an entity's strategic operating, investing and financing policies without the co-operation of others". In assessing whether a not-for-profit organization controls another not-for-profit organization, attention would be given to whether it can appoint a majority of the board of directors, whether the other organization holds resources that must be used for the reporting organization's benefit (i.e., has an "economic beneficial interest") and the extent to which the reporting organization is responsible for the other organization's deficits or liabilities.

In addition, disclosures would be required where a not-for-profit organization has significant influence or has an economic beneficial interest, without control, in another organization. These disclosures would include the nature, amount, and purposes for which the assets subject to the economic beneficial interest are to be used.

A not-for-profit organization could either consolidate or equity account (that is, the investment is recorded at cost adjusted for its share of the profits or losses of the investees) for any controlled *profit-oriented* enterprise subsidiaries. Any investments in profit-oriented enterprises over which an organization has a significant influence would be accounted for on the equity basis.

Financial Statement Presentation

Current CICA *Handbook* guidance suggests that financial statements of not-for-profit organizations include a balance sheet and the equivalent to an income statement, statement of retained earnings, and statement of changes in financial position.

The Re-Exposure Draft proposes that financial statements of a not-for-profit organization using fund accounting would show totals for the organization as a whole for each financial statement item. Accordingly, more complete information would be provided about the organization's economic resources, obligations and net assets as well as its operations, and its sources and uses of cash.

An exception exists for organizations reporting on a restricted fund accounting basis. In this case, totals on the statement of revenues and expenditures and surplus would be provided only for the unrestricted fund, the restricted funds as a whole, and the endowment funds as a whole. Accordingly, a reader of the financial statements could not be misled into believing that the restricted surplus is part of the unencumbered surplus, as was suggested by certain respondents to the Exposure Draft.

Conclusion

The proposed standards in the Re-Exposure Draft represent the evolution to date of accounting and reporting standards for not-for-profit organizations. These proposed standards are consistent with the CICA *Handbook*'s financial statement concepts and have taken into account many of the comments and concerns raised by those responding to the Exposure Draft. The hope is that the proposed standards will be accepted and the CICA will have come one step closer to establishing more complete accounting standards for not-for-profit organizations.

FOOTNOTES

1. *Financial Reporting for Non-profit Organizations: A Research Study*, The Canadian Institute of Chartered Accountants, Toronto: 1980.
2. The Canadian Institute of Chartered Accountants *Handbook* Section 1000.
3. Cynthia Orr, "CICA Exposure Draft: Non-profit Organizations", (1992) 11 *Philanthrop.* No. 2, p. 35.
4. See the following articles: Christopher I. Torres, "Viewpoint: Generally Accepted Accounting Principles for Non-Profit Organizations – A University Perspective", (1988), 7 *Philanthrop.*, No. 3, p. 29; L.S. Rosen, "CICA Exposure Draft: A Comment", (1992), 11 *Philanthrop.*, No. 2, p. 40; and Thomas H. Beechy and Brenda Zimmerman, "Putting the Cart Before the Horse", (1992), 11 *Philanthrop.*, No. 3, p. 33.

[Thomas Beechy's comments on the Re-Exposure Draft begin on p. 43.]

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