

Current Accounting Deliberations: Issues and Concerns For Non-Profit Organizations*

COLIN GRAHAM

Clarkson Gordon, Chartered Accountants

In July the Accounting Standards Committee of the Canadian Institute of Chartered Accountants issued an Exposure Draft entitled *Amendments to the Handbook to Incorporate Non-profit Organizations*. Comments to the CICA were requested by September 30, 1987 and it is hoped the Amendments can be approved at the January 1988 meeting of the Accounting Standards Committee. That will be the last step necessary to bring non-profit organizations within the ambit of the Accounting and the Auditing Sections of the *Handbook*. (The Auditing Section was amended in the fall of 1986.)

Auditing Section of the CICA Handbook

Effective for audit reports dated after December 31, 1986, the applicability of the Auditing Recommendations was extended to non-profit organizations. With this expansion in scope, the *Handbook* now provides, in Section 5510.H, an example of an auditor's report with a scope reservation arising from the auditor's inability to verify the completeness of the records on donation revenues. In this regard pages 111-113 of the CICA Research Study *Financial Reporting for Non-profit Organizations*, include a discussion of the factors that could allow an auditor to decide *not* to have this qualification.

Exposure Draft

Briefly, the Exposure Draft proposes:

1. The Accounting Recommendations now in the CICA *Handbook* should apply to non-profit organizations, with some reservations—primarily deferral, for the moment, of the question of the treatment of fixed assets and depreciation.

The reasoning: the Accounting Recommendations in the CICA *Handbook* apply to enterprises in many diverse industries because, in determining the appropriate accounting and reporting standards, emphasis is placed on the circumstances and the nature of transactions,

* This article has been developed from a paper presented to the 44th Annual Conference of the Association canadienne du personnel administratif universitaire/Canadian Association of University Business Officers held in Quebec City. The conference theme was *Issues and Options in University Management*.

rather than on the type of organization. Thus, transactions similar in substance should be accounted for in similar way by all organizations. Implicit in the recommendations is the expectation that all non-profit organizations will adopt the accrual basis of accounting if they have not already done so.

2. There should be a new *Handbook* section on non-profit organizations with specific recommendations dealing with the measurement and disclosure of pledges, donated services, materials and facilities, restricted amounts, pooled investment funds and income tax status.
3. Pending completion of a current Accounting Standards Committee project on fixed assets, non-profit organizations should disclose details of the practices followed in accounting for fixed assets, including, where relevant, the matters now dealt with in Section 3060, Fixed Assets: basis of valuation, depreciation written, appraisals recorded.
4. Approval of the proposals set out in the Exposure Draft would mean deletion of the reference, in *Handbook* Section 5100.05, to non-profit organizations as an example of the circumstances in which the use of what is termed “an appropriate disclosed basis of accounting other than generally accepted accounting principles” may be appropriate.

Some Canadian Literature

Research in this area published by the CICA goes back to the 1960s, to a 1965 Research Study, *The Hospital Audit*, which was followed by Ross Skinner’s 1969 Research Study, *Canadian University Accounting* and, in 1972, his *Accounting Principles—A Canadian Viewpoint*. In 1980 came the Research Study, *Financial Reporting for Non-profit Organizations/L’information financière des organismes sans but lucratif*. (Available from the CICA at 150 Bloor Street West, Toronto, M5S 2Y2.)

The universities have published the *Guide to Accounting Principles, Practices and Standards of Disclosure for Colleges and Universities of Ontario* (1977, looseleaf), and *Guide to Accounting Principles, Practices and Standards of Disclosure for Universities and Colleges of Canada* (1984, looseleaf).

The Canadian Hospital Association has published and periodically revised the *Canadian Hospital Accounting Manual*, and the Institute of Chartered Accountants of Ontario published *Financial Reporting Guidelines for Ontario Hospitals* in 1985.

In May 1987, Ross Skinner published *Accounting Standards in Evolution*, which achieves effectively his three principal objectives:

- to recount in an organized fashion the standards that govern financial reporting today;
- to explain why they take the form that they do, i.e., to explore the general theory underlying today’s standards and the particular thinking that has influenced the form taken by individual standards; and

- to evaluate critically the standards and underlying theory so as to appraise strengths and weaknesses with a view to stimulating discussion and possible improvement.

Public Sector Accounting and Auditing Committee

The Public Sector Accounting and Auditing Committee was established in 1981, separate from the two committees, Accounting Standards and Auditing Standards, that govern the *Handbook*. Its mandate is to consider matters of public sector accounting and auditing theory and practice and to render, on its own authority, such pronouncements as it considers in the best interest of the community as a whole. It is also charged with providing for the growth of Canadian accounting and auditing literature for the public sector by encouraging specialized studies.

The Committee has issued three Accounting and three Auditing Statements of Recommendations:

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| <i>Accounting</i> | <ol style="list-style-type: none"> 1. Disclosure of Accounting Policies 2. Objectives of Government Financial Statements 3. General Standards of Financial Statement Presentation for Governments |
| <i>Auditing</i> | <ol style="list-style-type: none"> 1. Auditing in the Public Sector 2. Audit of Financial Statements in the Public Sector 3. Auditing for Compliance with Legislative and Related Authorities |

Since bodies such as universities and hospitals, substantially supported by government, are eyed by both CICA accounting principles groups, getting agreement on exclusive territories may prove difficult.

The Exposure Draft proposes that the CICA *Handbook* Recommendations not apply to federal, provincial, territorial or local governments; the Accounting Recommendations of the Public Sector Accounting and Auditing Committee are intended to apply to governments. But the Draft also says that organizations or funds of governments that are not profit-oriented may base their accounting policies on *either* set of Recommendations, selecting the basis that is the most appropriate to their individual objectives and circumstances.

The CICA *Handbook* definition of “non-profit organizations” is proposed to be: “those organizations in which there is normally no transferable ownership interest and from which the members or contributors do not receive any direct economic gain—and that are formed, for example, for social, educational, health or philanthropic purposes”. Clearly universities and hospitals are included, but currently the Public Sector group is trying to define the “government financial reporting entity”. This definition will be important. Is it the government’s Consolidated Revenue Account, or is it all activities funded in any way by government, or is it only activities directly accountable to a legislature or minister, thus excluding those organizations like universities, hospitals

and many social agencies with delegated financial powers, operational authority, boards and management?

This same jurisdictional quandary exists in the United States between the Financial Accounting Standards Board (FASB)—business and non-profit—and the Government Accounting Standards Board (GASB)—government. At the root is the unresolved question of whether “business” accounting is generally appropriate for “nonbusiness” enterprises, as the latter are oriented to service and not oriented to profit. One other reason why a separate board has been thought to be needed for government accounting is the overriding importance in government of adhering to the prescriptions of statutes that often specify in great detail actions to be taken or expenditures to be made or not made.

In 1986 GASB formally added to its agenda the subject of “college and university accounting”, thus bringing to the fore the possibility of differing interpretations in educational institution accounting between private and state-funded entities. The National Association of College and University Business Officers, as well as the Health Care Financial Management Association, is making a strong appeal to both boards to avoid conflicting accounting standards. *The Philanthropy Monthly* sees this as a real danger because of GASB’s “entity” orientation and FASB’s “transactional” orientation.

Accountability

Administrators, staff and boards of non-profit organizations have a vital and continuing interest in improving management and services and in obtaining the best possible value for their money. Improvement requires involvement, strong processes and continual review. In this regard I recommend as good reading, *Canadian Hospitals—Accountability and Information for Cost Effectiveness: An Agenda for Action*, published in June by the Canadian Comprehensive Auditing Foundation. This paper focuses in particular on the question of how members of boards of trustees can be informed in a way that is commensurate with the scope and level of their responsibilities.

Exposure Draft Contents

Back to the Exposure Draft. Non-profit organizations should not have serious problems with the additional material in the proposed *Handbook* section. Neither recording pledges if they can be valued, nor recording donated materials and facilities if the organization controls them and they can be measured, should be difficult. Recording donated services will be proposed as desirable if they would otherwise be purchased, but would not be required.

Preliminary reviewers of some of the Exposure Draft material suggested more than a dozen other topics that might usefully have been covered. It was the view of the Accounting Standards Committee that additional topics should be deferred, in favour of concentrating on the main issue of bringing non-profit organizations into the *Handbook*.

Certainly there may be impacts on the financial statements of non-profit organizations from Recommendations currently set out in the *Handbook*. A major impact for some organizations may arise from the new accounting-for-pension-costs recommendations which are effective for fiscal years beginning after December 1, 1986. The changes for defined pension plans are threefold:

1. Reflection of best estimates of most probable outcomes;
2. Reasonable and systematic measurement with a reduced choice of cost allocation methods and amortization periods; and
3. Increased disclosure of the actuarial value of accrued pension plan obligations and the "market related" values of pension plan assets.

The result should be an improved understanding of the costs and obligations of pension plan commitments and more comparable information between institutions. To expense what is funded, as is done currently, is to deal with the financing aspects only and to produce non-comparable benefits costs between organizations and between years. Pensions are deferred compensation and therefore part of remuneration and related to service.

When should non-profit organizations follow this improved pension cost disclosure? If the *Handbook* now applied formally, compliance would be required for fiscal years now in progress. If non-profit-organizations come into the *Handbook* next January, it will be required for fiscal years starting after that date.

Developments in Non-Profit Reporting Outside Canada

In the Fall 1986 issue of *The Philanthropist* (Vol. VI, No.3), in an article entitled "Financial Accounting for Non-Profit Organizations: 1986 Update", I outlined some developments which were occurring outside Canada. More recently there has been further action in the United States as the Financial Accounting Standards Board continues to develop accounting standards for non-profit organizations:

- FASB issued an Exposure Draft, *Recognition of Depreciation by Not-for-Profit Organizations*, for comment by April 1987. It would require, without exception, *all* non-profit organizations to recognize the cost of using up long-lived tangible assets (depreciation) in general purpose external financial statements. Disclosure would be required of depreciation expense for the period, balances by major class (by nature or function), accumulated depreciation, and a general description of the method of computing depreciation. There has been a broad response, but the only major change being considered by FASB is implementation for fiscal years starting in 1988 or perhaps even later, rather than 1987. Depreciating fixed assets would be a very significant change for many United States non-profit organizations who generally, like many in Canada, do not depreciate. (Those interested in this subject should read Dan Robinson's 1986 monograph produced for the National

Association of University Business Officers, *Capital Maintenance for Colleges and Universities*.)

- Work is progressing on an Exposure Draft on donated goods and services which is expected later this year.
- Professor William Holder's Research Report for FASB, *The Not-for-Profit Organization Reporting Entity*, has been published. He supports the accounting consolidation of entities that are controlled (as opposed to reporting only for legal entities) and states, "The concept of control defines the financial reporting entity in terms of the authority and responsibility for establishing policies, the ability to direct operations and the responsibility for the same, and the access to, and responsibility for assets and liabilities". (The study is available for U.S. \$11 from *The Philanthropist Monthly*, Box 989, New Milford, CT 06776, U.S.A.)