CHARTERED PROFESSIONAL ACCOUNTANTS CANADA

Financial Reporting Alert

ACCOUNTING STANDARDS FOR NOT-FOR-PROFIT ORGANIZATIONS (ASNPO)

JULY 2018

Tangible Capital Assets, Intangible Assets and Collections Held by Not-for-Profit Organizations (NFPOs)

In March 2018, the Accounting Standards Board (AcSB) issued the following new standards in Part III (Accounting Standards for Not-for-Profit Organizations) of the *CPA Canada Handbook—Accounting* (the *Handbook*):

- Section 4433, *Tangible Capital Assets Held by Not-for-Profit Organizations*;
- Section 4434, *Intangible Assets Held by Not-for-Profit Organizations*; and
- Section 4441, *Collections Held by Not-for-Profit Organizations*.

Sections 4433, 4434 and 4441 (the "new standards") replace Section 4431, *Tangible Capital Assets Held by Not-for-Profit Organizations*, Section 4432, *Intangible Assets Held by Not-for-Profit Organizations* and Section 4440, *Collections Held by Not-for-Profit Organizations* in Part III of the *Handbook*, respectively.

This *CPA Canada Financial Reporting Alert (Alert)* highlights key changes resulting from the new standards and considers some possible assurance implications. The guidance in Sections 4433, 4434 and 4441 that was retained from previous Sections 4431, 4432 and 4440 is not the primary focus of this *Alert*.

What are the Main Objectives of the New Standards?

The main objectives of the new standards are:

- To remove redundancies between Part II (Accounting Standards for Private Enterprises) and Part III of the *Handbook* for tangible capital assets and intangible assets by eliminating guidance in Part III that duplicates guidance in Section 3061, *Property, Plant and Equipment* in Part II. Instead, consistent with other standards in Part III, NFPOs will now be referred to the relevant standards in Part II. Any guidance that was unique to Part III was carried forward and included in Sections 4433 and 4434; and
- To increase consistency in practice in the recognition and measurement of collections by NFPOs and highlight the existence of collections by expanding the scope of the guidance contained in Part III on collections to include guidance on recognition, measurement and disclosure.

Who Applies the New Standards?

The principal users of the new standards will be NFPOs in the private sector that apply Part III of the *Handbook*[1] and:

- Own, acquire, construct or develop tangible capital assets (or recognize tangible capital assets in accordance with Section 3065, *Leases* in Part II of the *Handbook*);
- Own, acquire, construct or develop intangible assets; or
- Hold collections.

Key Concept: Sections 4431 and 4432 provided smaller NFPOs with an accounting policy choice to not apply all of the requirements of those standards. Instead, a qualifying NFPO could elect to only make certain disclosures related to tangible capital assets and intangible assets. This accounting policy choice could only be applied if the average annual revenues recognized in the statement of operations for the current and preceding period for the NFPO, and any entities it controls, was less than $500,000. This accounting policy choice was retained in Sections 4433 and 4434, respectively. Such NFPOs, however, are encouraged to follow all of the requirements of Sections 4433 and 4434 rather than electing to only make certain disclosures related to tangible capital assets and intangible assets.

When are the New Standards Effective?

The new standards are effective for annual periods beginning on or after January 1, 2019. Accordingly, an NFPO with a March 31 fiscal year-end would be required to apply the new standards for the first time in its annual financial statements for the year ending March 31, 2020. Earlier application is permitted.

1 NFPOs in the private sector may apply Part III or Part I (International Financial Reporting Standards) of the *Handbook*.

What are the Key Changes?

This *Alert* addresses the key changes as a result of the new standards in two sections:

- A: Tangible Capital Assets and Intangible Assets Held by Not-for-Profit Organizations (Sections 4433 and 4434); and
- B: Collections Held by Not-for-Profit Organizations (Section 4441).

A: Tangible Capital Assets and Intangible Assets Held by Not-for-Profit Organizations (Sections 4433 and 4434)

Cost of Contributed Tangible Capital Assets

The cost of a contributed tangible capital asset is deemed to be its fair value at the date of contribution plus all costs directly attributable to its acquisition, including installing it at the location and in the condition necessary for its intended use.

Previously, there was no guidance on how to determine the cost of a contributed tangible capital asset.

Amortization of Tangible Capital Assets

There are two key changes related to the amortization of tangible capital assets:

1. NFPOs will now follow the guidance included in Section 3061 on amortization. This means that amortization is recognized in a rational and systematic manner appropriate to the nature of a tangible capital asset with a limited life and its use by the NFPO. The amount of amortization that is recognized as an expense in the statement of operations is the greater of:
    a. The cost less salvage value over the life of the asset; and
    b. The cost less residual value over the useful life of the asset.

    Previously, amortization was recognized based only on (b) above.

2. NFPOs will now follow the guidance included in Section 3061 on componentization. The cost of a tangible capital asset made up of significant separable component parts is allocated to the component parts when practicable and when estimates can be made of the lives of the separate components. Each component is then amortized in accordance with the guidance included in Section 3061 on amortization as described above.

    Previously, componentization was not required.

Key Concept: An NFPO will now need to separate tangible capital assets into their significant component parts when practicable and when estimates can be made of the lives of the separate components.

Recognizing Partial Impairments of Tangible Capital Assets and Intangible Assets

- When conditions indicate that a tangible capital asset or an intangible asset is impaired, the net carrying amount of the asset is written down to the asset's fair value or replacement cost (as selected on an asset-by-asset basis by the NFPO).
- A tangible capital asset or an intangible asset may be impaired when conditions indicate that the asset no longer contributes to the NFPO's ability to provide goods and services, or that the value of future economic benefits or service potential associated with the asset is less than its net carrying amount.
- Write-downs of tangible capital assets or intangible assets are accounted for as expenses in the statement of operations and are not reversed.
- A tangible capital asset or an intangible asset may be integrated with other assets such that it may be necessary to consider the value of the asset's future economic benefits or service potential for the group of integrated assets as a whole. In such cases, a write-down may be recognized and measured for the group of assets rather than for the individual asset. Any write-down is allocated to the assets of the group on a pro rata basis using the relative carrying amounts of those assets.

Key Concept: An NFPO will now need to consider partial impairments on tangible capital assets and intangible assets, not only full impairments.

Disclosure of Impairment Losses

NFPOs will now follow the guidance included in Section 3063, *Impairment of Long-Lived Assets* in Part II of the *Handbook* on the disclosure of impairment losses, as well as the disclosure requirements in Sections 4433 and 4434.

In the period in which an impairment loss is recognized for a tangible capital asset or an intangible asset, an NFPO discloses:

- Whether the impairment recognized is based on the asset's fair value or replacement cost;
- A description of the impaired asset;
- A description of the facts and circumstances leading to the impairment; and
- If not separately presented on the face of the statement of operations, the amount of the impairment loss and the caption in the statement of operations that includes that loss.

Transitional Considerations

An NFPO applies Sections 4433 and 4434 prospectively to tangible capital assets acquired on or after the application date, however; the following exceptions to prospective application may be applied:

- An NFPO is permitted to apply the requirements for componentization to tangible capital assets held at the date Section 4433 is first applied. However, an NFPO may find it difficult to determine the amounts to allocate to the component parts of tangible capital assets retrospectively. To address this, the transitional provisions of Section 4433 allow an NFPO to allocate the cost of tangible capital assets held at the date Section 4433 is first applied, and the related amortization, to their component parts based on their relative:

- Cost or fair value at the date the assets were acquired; or
- Fair value or replacement cost at the date Section 4433 is first applied.[2]

- An NFPO that applies Section 4433 or 4434 for the first time is permitted to recognize an adjustment to opening net assets at the date Section 4433 or 4434 is first applied to reflect partial impairments of tangible capital assets or intangible assets existing at that date. This prevents an NFPO from having to record partial impairments in the current period that occurred prior to the date of applying Section 4433 or 4434.

The above two departures from prospective application can only be applied when an NFPO prepares its annual financial statements relating to the fiscal year in which Section 4433 or 4434 is first applied.

Key Concept: Sections 4433 and 4434 are applied prospectively, however; there are transitional provisions allowing for departures from prospective application of componentization and recognizing partial impairments.

B: Collections Held by Not-for-Profit Organizations (Section 4441)

Nature of Collections

Collections are works of art, historical treasures or similar assets that are:

- Held for public exhibition, education or research;
- Protected, cared for and preserved; and
- 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 or for the direct care of the existing collection.

Works of art, historical treasures and similar items that are not part of a collection are accounted for based on their intended use in accordance with Section 3032, *Inventories Held by Not-for-Profit Organizations*, Section 4433, or Section 4434 in Part III of the *Handbook*, or Section 3051, *Investments* in Part II of the *Handbook*.

Initial Recognition and Measurement

- Collections are recorded on the statement of financial position at either cost or nominal value.
- An NFPO accounts for all collections using the same method, except that when an NFPO accounts for its collections at cost and cost cannot be reasonably determined for one or more contributed items or collections, those items are recorded at nominal value. This does not preclude the remaining items in the NFPO's collections from being recorded at cost.
- The cost of a collection is the amount of consideration given up to acquire items making up the collection and includes all costs directly attributable to the acquisition of the collection items.

2 An NFPO can use whichever value is most readily determined.

- For items contributed to collections, cost is deemed to be fair value at the date of contribution plus all costs directly attributable to the acquisition of the collection items. Fair value may be estimated using market or appraisal values.
- An item in a collection purchased by an NFPO at substantially below fair value would be recognized at its fair value with the difference between the consideration paid for the item and fair value reported as a contribution in accordance with Section 4410, *Contributions—Revenue Recognition* in Part III of the *Handbook*.
- For a purchased collection item recorded at nominal value, the difference between the purchase price for the item and nominal value is recognized in the statement of operations. In addition, all other costs attributable to the purchase of the collection item are recognized in the statement of operations.
- The cost incurred in protecting and preserving collection items is recognized in the statement of operations as a repair or maintenance expense in the period incurred.

Key Concept: Collections must now be recorded at either cost or nominal value on the statement of financial position. All collections are accounted for using the same method.

Amortization of Collections

Collections are not subject to amortization due to their nature, which requires an NFPO to preserve these assets in perpetuity.

Recognizing Partial Impairments of Collections

The value of a collection or an item in a collection that is recorded on the statement of financial position at cost is written down whenever events or changes in circumstances indicate that its net carrying amount may exceed its fair value. The net carrying amount of the collection or the item in the collection is written down to its fair value or replacement cost (as selected on an item-by-item basis by the NFPO).

Write-downs of a collection or an item in a collection are accounted for as expenses in the statement of operations and are not reversed.

Any write-down of a collection is allocated to the items in the collection recorded at cost on a pro rata basis using the relative carrying amounts of those items.

Disposals of Collections

On disposal of items contributed to a collection that are subject to external restrictions, when the net proceeds on disposal exceed the net carrying amount, the difference is recognized in accordance with Section 4410.

On disposal of items in a collection that are not subject to external restrictions, or when the net carrying amount exceeds the net proceeds on disposal, the difference between the net proceeds on disposal and the net carrying amount is recognized in the statement of operations.

The net proceeds are the proceeds from disposal less any costs directly attributable to the disposal.

Presentation and Disclosure of Collections

The amount recognized as collections is presented on a separate line in the statement of financial position.

An NFPO that accounts for its collections at cost discloses a description of any items or collections that are recorded at nominal value.

For disposals of collection items, an NFPO discloses:

- The proceeds from any disposals in the period and how the proceeds were used;
- The amount of any proceeds from prior periods spent during the current period, and how the proceeds were used; and
- The total amount of proceeds not yet spent at the end of the reporting period, and if not separately presented on the face of the statement of financial position, the caption in the statement of financial position that includes the proceeds not yet spent.

In the period in which a write-down is recognized, an NFPO discloses:

- A description of the facts and circumstances leading to the write-down;
- The amount of the write-down measured using each fair value and replacement cost; and
- If not separately presented in the statement of operations, the amount of the impairment loss from the write-down and the caption in the statement of operations that includes that loss.

All other disclosure requirements from Section 4440 were carried forward to Section 4441.

Transitional Considerations

Section 4441 is applied retrospectively, however; the following simplifications to full retrospective application may be applied:

- When an NFPO applies the accounting policy choice to account for its collections at cost and applies Section 4441 for the first time, an NFPO is permitted to capitalize retrospectively the items in a collection acquired in previous periods and held at the date Section 4441 is applied at their:
  - Cost or fair value at the date of acquisition; or
  - Fair value or replacement cost at the date Section 4441 is first applied.[3]
- An NFPO that applies Section 4441 for the first time is permitted to recognize an adjustment to opening net assets at the date Section 4441 is first applied to reflect partial impairments of collections existing at that date.

An NFPO can only apply these elections when preparing its annual financial statements relating to the fiscal year in which Section 4441 is first applied.

Key Concept: Section 4441 is applied retrospectively, however; there are transitional provisions allowing for simplified retrospective application for collections accounted for at cost and for recognizing partial impairments.

3 An NFPO uses whichever value is most readily determined.

Are There Any Consequential Amendments?

A consequential amendment was made to Section 1501, *First-Time Adoption by Not-For-Profit Organizations* in Part III of the *Handbook*.

This consequential amendment allows an NFPO, applying the accounting policy choice to account for its collections at cost, to apply the transitional provisions permitting it to capitalize retrospectively the items in a collection acquired in previous periods and held at the date of transition to ASNPO using one of two alternative methods, as described above.

What are the Possible Assurance Implications?

The changes discussed in this *Alert* as a result of the adoption of Sections 4433 and 4434 may require the practitioner and management to discuss:

- The identification of whether any tangible capital assets recognized after the date Section 4434 is first applied (or that existed at the date Section 4434 is first applied if the transitional provisions to apply componentization to those assets are applied) are made up of significant separable component parts;
- The estimated salvage value, residual value, life and useful life of each tangible capital asset recognized after the date Section 4434 is first applied for the purpose of determining the appropriate amount of amortization to record each period;
- Whether any indicators of impairment exist for a recognized tangible capital asset or intangible asset and, if so, how to appropriately measure and disclose the potential impairment loss; and
- Transitional considerations upon adopting Sections 4433 and 4434.

The changes discussed in this *Alert* as a result of the adoption of Section 4441 may require the practitioner and management to discuss:

- The accounting policy choice selected in measuring collections;
- To the extent that collections are measured at cost, whether cost can be determined for all contributed items and collections;
- Whether any indicators of impairment exist for a recognized collection and, if so, how to appropriately measure and disclose the potential impairment loss;
- Whether any items included in a collection were contributed and, if so, how to measure the fair value of these collection items upon initial recognition; and
- Transitional considerations upon adopting Section 4441.

In addition, the following considerations may be relevant in assurance engagements:

- Additional procedures in evaluating the appropriateness of the separation of tangible capital assets into significant separable component parts and the amortization thereof;
- Additional procedures in assessing and calculating partial impairments on tangible capital assets, intangible assets and collections, including consideration as to whether the use of an expert is required;
- Updating the documentation of the understanding of the entity so that it appropriately reflects the current state (e.g., the entity's identification of significant separable component parts of tangible capital assets, the selection of its accounting policy for the measurement of collections, etc.); and

- Evaluation of the adequacy and appropriateness of disclosures required by the new standards.

Other Resources

AcSB

- Basis for Conclusions—Accounting Standards Improvements for Not-for-Profit Organizations
- FYI Article—Change Is Coming to Accounting Standards for Not-for-Profit Organizations

CPA Canada

- Webinar—AcSB Update: Not-for-Profit Organizations Following Part III

Comments

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