SCSBC Seminar

March 11, 2014

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Charities Seminar

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Loewen Kruse Chartered Accountants

- Loewen Kruse specializes in charities and not-for-profit organizations
- We provide the following services:
  - Auditing
  - Accounting and Bookkeeping
  - T3010 E(13) preparation
  - Charities consulting

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- Serving the Charitable Sector, including:
  - Intermediate/Long Term Care Organizations
  - Independent Schools & Post Secondary Institutions
  - Religious Organizations
  - Social & Assisted Living Organizations
  - Camps
  - Relief and Development Agencies
  - Youth Organizations

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Agenda

- Changes to the Accounting Profession in Canada
- Accounting Update for NPOs
- Auditing Update
- Top Accounting Mistakes Organizations Make
- Tax issues for non-charity NPOs
- Micro Entity Audits

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Changes to the Accounting Profession in Canada

- The three major accounting professions in Canada are in the process of unifying
  - Certified General Accountants
  - Certified Management Accountants
  - Chartered Accountants
- The new designation will be "*Chartered Professional Accountant*", or "*CPA*"

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Changes to the Accounting Profession in Canada

- Unification is at the provincial level, with both provincial and federal organizations
  - In BC, The CMAs, CGAs and CAs have approved unification
- What does this mean to you?
  - One regulatory body
  - No confusion between designations

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Accounting Update for NPOs – New Proposed Standards

- *Statement Of Principles* published in April 2013 by the Accounting Standards Board of Canada to make changes to the Not-For-Profit Accounting Standards
- Actual changes are still a year (minimum) away
- However, we must be aware of the changes so that we can plan accordingly

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Accounting Update for NPOs – New Proposed Standards

- These changes apply to all NPOs (charities, societies, clubs, schools, unions, government)
- However, these changes pertain to AUDITED and REVIEWED financial statements *only*
- Comments deadline for the *Statement of Principles* is December 15, 2013
- Exposure Draft to be released in 2014

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Accounting Update for NPOs – New Proposed Standards

Revenue Recognition – externally restricted contributions

- Restricted Fund Method, and the Deferral Method of accounting for restricted contributions are being eliminated
- Proposed: Only defer revenue if there is a liability
  - It will be more difficult to defer externally restricted contributions

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Accounting Update for NPOs – New Proposed Standards

Revenue Recognition – externally restricted contributions (continued)

- Effectively, two policies have been eliminated.
- Replaced with: you must recognize the restricted contribution as revenue, unless a liability is still attached to the donation
- Key concept: *A deferred contribution exists only when the contribution meets the definition of a liability*

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Accounting Update for NPOs – New Proposed Standards

Revenue Recognition (old Deferral Method)

- Old method: Set up Deferred Revenue for Capital Asset contributions, and then recognize it at the same rate as amortization
- Proposed method: Only set up a deferred contribution if the donation meets the definition of a liability

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Accounting Update for NPOs – New Proposed Standards

Revenue Recognition (old Deferral Method)

- Example: A person donates $1 million for a new building.
  - Old method (deferral method): amortize the donation over the life of the building (approximately $40,000 per year, over 25 years)
  - New method: show a $1 million donation once the building is completed.

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Accounting Update for NPOs – New Proposed Standards

Revenue Recognition – (old Restricted Fund Method)

- Old method – Recognize revenue in the restricted fund, regardless of restrictions
- Proposed method – must defer the contribution if a liability still exists

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Accounting Update for NPOs – New Proposed Standards

Revenue Recognition

- Big question: How to recognize revenues for projects, such as missions trips, deputized giving for missionaries, etc?
- Cannot recognize <u>pledges</u> as revenue, as they are not legally enforceable, (pledges to not meet the definition of an asset, the NPO does not yet have control)

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Accounting Update for NPOs – New Proposed Standards

Revenue Recognition

- Recognize endowment contributions as revenue in the Statement of Operations, NOT as a direct increase in net assets/fund balances
- **Note – "Fund Accounting" will still exist!**

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Accounting Update for NPOs – New Proposed Standards

The **exemptions for small organizations not to capitalize assets** will be eliminated

- Currently, an NPO with revenues under $500,000 can elect to expense capital asset additions
- The size exemption was an arbitrary amount that was set twenty years ago, in order to accommodate small NPOs, and encourage their adoption to GAAP
- All NPOs will need to capitalize capital assets retrospectively

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Accounting Update for NPOs – New Proposed Standards

Consolidation of controlled entities

- Currently, we use Cost Method, or Consolidation Method to account for controlled entities
- Proposed: Must consolidate controlled NPOs
  - Subject to an exclusion from consolidation of a large number of immaterial organizations (*Brownie Rule*)

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Accounting Update for NPOs – New Proposed Standards

Consolidation of controlled entities

- "Control" can often be determined by the charity's bylaws
- Example
  - Charity "A" appoints board of Charity "B" = Control and consolidation
  - Charity "A" has same board members as Charity "B" = not necessarily controlled. No consolidation.

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Accounting Update for NPOs – New Proposed Standards

Consolidation of controlled entities

- Joint boards does not necessarily constitute "control"
  - Example: Charity, Foundation, and society (three entities) all same board members on each of the three boards – They may be related, but there may not be "control"
    - This may mean that all entities need not to be consolidated
    - The AcSB hopefully will provide guidance on this subject

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Accounting Update for NPOs – New Proposed Standards

Consolidation of controlled entities

- Must account for controlled "for-profit" entities using the Equity Method
  - Old method: Consolidation or Equity Method
  - Proposed: Equity Method only, so as not to co-mingle the NPO assets, liabilities and operations with that of the controlled for-profit entity

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Accounting Update for NPOs – New Proposed Standards

Income Statement Presentation

- Must present expenses by function on the Income Statement and disclose expenses by object in the notes to the financial statements
  - *"Function"* examples: fundraising, general administrative, programs,
  - *"Object"* examples: office, utilities, salaries, amortization, etc.

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Accounting Update for NPOs – New Proposed Standards

Income Statement Presentation

- Presenting (on income statement) expenses by function and disclosing (in the notes) expenses by object should assist in addressing accountability and stewardship responsibilities
- If you have only one function, then you present expenses by object on income statement, and disclose expenses by function in the notes

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Auditing Update

- Donation Qualification on Auditor's Report
- New Audit Report
- New Review Engagement Report

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Donation Qualification

- The Donation Qualification was introduced over twenty years ago
- *"we were unable to verify the completeness of donation revenue"*
- It used to be a default to include the donation qualification in the auditor's report

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Donation Qualification

- Now, the profession looks at various factors that would eliminate the donation qualification
  - Strength of internal controls
  - Donations as a percentage of revenues
  - Nature of donations (cash vs. cheques)
- Conclusion: We are eliminating the donation qualification in our audits, where appropriate

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New Auditor's Report

- **New Exposure Draft released September 30, 2013**
- Canada proposes to adopt International Auditing Standards related to the Auditor's Report, released (in Exposure Draft) by the International Auditing and Assurance Standards Board (IAASB).

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New Auditor's Report

- **New Exposure Draft**
- Assuming the proposed new and revised ISAs are issued as final standards, the effective date would be for periods beginning on or after December 15, 2015, although the IAASB is seeking input on whether an earlier effective date would be feasible

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New Auditor's Report

- **New Exposure Draft**
- Some pertinent proposed changes:
  - Commentary by the auditor on matters most significant in determining an opinion
  - Reporting on whether management's use of the going concern assumption is appropriate
  - Disclosure of the partner's name in the report
  - Enhanced description of the responsibilities of the auditor, management, and directors

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New Review Engagement Report

- New Review standards to be implemented for periods ending on or after December 14, 2015
- These new standards will require more extensive and rigorous procedures

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Common Issues – a list of our top recommendations made in 2013

General Issues

- Fund Accounting
  - Fund Accounting requires an advanced understanding of accounting in order to reconcile the funds
  - Common mistake – restricted funds do not balance
  - ***Remedy:*** when hiring an accountant, ensure that they have fund accounting experience.

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Common Issues

CRA Compliance Issues

- T3010 is due six months after year-end
  - Include your Basic Information Sheet
  - Update your information for CRA on the Basic Information Sheet
- Funding “good causes” that are not your own is prohibited
  - This is not allowed under CRA guidelines
  - You must spend your resources on your charitable activities

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Common Issues

CRA Compliance Issues

- Official Donation Receipts missing certain information
  - Refer to CRA website for sample donation receipts
- Main culprits:
  - No appraiser used for gifts in kind over $1,000
  - “Location of receipt issued” is DIFFERENT REQUIREMENT than that of the charity’s address

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Common Issues

CRA Compliance Issues

- Issuing donation receipts for services
  - Not allowed. Only allowed to receipt gifts of property
- Issuing receipts to other charities
- "RR" number rental

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Common Issues

Board Of Directors Issues

- Spending limits are not set for staff and management
- No Directors Liability Insurance
- Use of restricted funds to pay for unrestricted programs, and to cover shortfalls in the General Fund
  - This is very dangerous. This is a band-aid solution to a systemic problem. Also, the charity may be in breach of trust law

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Common Issues

Board of Directors Issues

- No formal *communicated* donation policy for restricted donations; not informing the donors that if a certain project is fully funded/complete, then any excess donations can be used for unrestricted purposes
  - ***Remedy*** – inform donors via website – printed in brochures

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Common Issues

General Accounting Issues

- Certain accounting entries not made by management – expectation for auditors to complete these entries
  - Investment activity, amortization, prepaid expenses, accounts payable/receivable reversals. This leads to inaccurate monthly/quarterly financial statements
  - ***Remedy:*** Ensure all pertinent entries are made monthly

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Common Issues

General Accounting Issues

- If separate donation software is used, the total donation dollar amount is often not reconciled to the general ledger
- Will lead to inaccuracies and incomplete information pertaining to revenues
- ***Remedy:*** Reconcile the donations between donation software and the general ledger, on a monthly basis

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Common Issues

Accounting Software Issues

- Some software programs allow bookkeepers to *Void* or *Delete* transactions.
- *Void* is okay. It keeps a history of what happened, what was voided, and when.
- *Delete* is bad. It may remove all history of how a transaction was handled, and may result in AR and AP sub-ledger totals not equalling the control account totals; a costly problem to resolve.

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Common Issues

Completeness issue

- Not all cash accounts are included in the general ledger
  - Coffee fund account
  - PayPal account
  - Various departments bank accounts (Youth account, Music Ministry account, regional chapters accounts)

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Non – Charities: Not for Profit Organizations – CRA Issues

NPOs that are *not charities*:

- Interest income from membership payment plans are to be deemed taxable
- NPO tax-exempt status would be at risk if *any business venture was carried on, even if the cash flow generated from the business activity funded the non-profit purposes of the NPO.*
  - Example - Cell phone towers on strata-owned condos

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Loewen Kruse Update: Micro-Entity Audits

- New Canadian Auditing Standards have provided an opportunity to provide a ***cost-effective audit*** for a Micro-Entity
- A Micro-Entity usually has:
  - Under $1 million in revenues
  - Minimal fund accounting in its financial statements
  - A proficient bookkeeper/accountant
  - Under ten staff members

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Loewen Kruse Update: Micro-Entity Audits

- A Micro-Entity audit is cost effective for small entities because of specialized procedures
- Contact us for more information regarding an audit of your Micro-Entity

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Thank You for Attending!

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