

**THE SALVATION ARMY
CANADA & BERMUDA**



Discussion Paper & Invitation to Comment

**TERRITORIAL CONSOLIDATED
FINANCIAL STATEMENTS**

**Finance Department
September 2006**

*Comments must be received by the Territorial Financial Secretary
by November 15, 2006*

PREFACE

This is the second Discussion Paper and Invitation to Comment issued by the Finance Department on behalf of the Territorial Finance Council (TFC) with respect to the Canada and Bermuda Territory's plan to issue consolidated financial statements incorporating the financial position and results of operations of all ministry units in the Territory.

The first paper, issued in September 2005, provided background information on the project and set out a series of tentative conclusions concerning how the next phase of the project might proceed. Feedback received from stakeholders, as well as further work conducted by the Finance Department, formed the inputs for the development of recommendations that were approved in principle by the Territorial Finance Council on April 5, 2006, and an implementation plan that was approved on July 12, 2006.

The purpose of this second paper is to bring stakeholders up to date on the project and solicit input concerning the implementation phase.

Written comments on the issues raised in the paper are welcomed from any stakeholder; however, it is hoped that, as a minimum, a response will be received from every divisional finance board in the Territory, representing the consensus of the members. In addition, individual comment letters are invited from any officer, non-officer Salvationist, or employee interested in the subject.

Comments will be most helpful if they are related to specific questions raised in this paper. Where there are concerns with any of the issues outlined, it would be most helpful if the comments explained clearly the problems perceived, as well as any potential alternatives. Respondents should reflect not only on the potential impacts in their own ministry unit or division, but on other ministry units, divisions, and the Territory as a whole.

Comments should be submitted electronically (by means of an e-mail or a Word document attached to an e-mail) to the Territorial Financial Secretary by November 15, 2006 at "Paul_Goodyear@can.salvationarmy.org". Copies of all submissions received by that date will be available to any interested party upon request. Due to the timelines associated with the project, while the Finance Department is open to receiving comments at any point during implementation, it may not be possible to revise certain aspects of the implementation plan for comments received after November 15, 2006.

EXECUTIVE SUMMARY

Since 1997, the Finance Department has been engaged in a process leading towards the issuance of consolidated financial statements for the Territory as a whole. As of March

31, 2006, all territorial and divisional headquarters entities have been incorporated into the territorial financial statements.

At its meeting of September 7, 2005 the Territorial Finance Council gave its approval in principle to the next phase of the project, which would see the financial position and results of operations of all ministry units brought into the financial statements.

The Finance Department subsequently issued the first discussion paper and invitation to comment in September 2005. It included 7 specific questions, and there were a total of 19 respondents. A summary of the responses received is included in Appendix A for reference.

Based on the comments received, further research and analysis, a final proposal was approved by the Territorial Finance Council at its meeting of April 5, 2006, and an implementation plan was later approved on July 12, 2006.

The key elements of the project are as follows:

1. Consolidated financial statements will first be published for the year ended March 31, 2010, although they will also be prepared at March 31, 2009 to ensure the availability of comparative information required for the 2010 financial statements, as well as to test the consolidation process to ensure that it is working effectively and on a timely basis.
2. The Shelby Web system has been approved as the territorial standard accounting system for all ministry units that perform their own accounting functions, except for units that are required to use another system due to government regulations. All existing Shelby system users will be converted to the Web version by September 30, 2007. Most other units will be expected to convert their systems by April 1, 2008.
3. A territorial chart of accounts is to be established for all units for Salvation Army reporting purposes by April 1, 2008.
4. A single public accounting firm will be engaged to conduct all required external audits of Salvation Army entities, effective for the fiscal year ending March 31, 2008. The firm of KPMG, LLP, Chartered Accountants, has been conducting the territorial headquarters audit for the past few years, and this firm has now been engaged to conduct all external audits in the Territory for the next few years. The audit contract will be tendered on a regular basis once full consolidation has been achieved.
5. The Territorial Finance Council recognizes the project's potential cost implications for small ministry units, particularly corps that have been able to rely on volunteers to date, but for whom increased requirements for accounting and financial reporting related to consolidation might result in their need to

engage the services of a regional accounting centre (RAC). As a result, the Territory will provide a grant to ministry units with a budget of up to \$300,000 to help offset the costs of regional accounting centre fees. This will result in free RAC services for units with a budget of up to \$100,000, and a reduced fee for units with a budget between \$100,000 and \$300,000.

BACKGROUND AND RATIONALE FOR CONSOLIDATION

During the past few years, Canadians have become more and more interested in charitable organizations and the degree to which they are accountable for their use of public funds. Approaches by members of the public and the media for information regarding the Army's use of donations and the percentage of costs spent on fundraising and administrative functions are becoming more frequent.

Currently, neither the Annual Charity Information Return (T3010) filed with the Canada Revenue Agency nor the audited financial statements published by Territorial Headquarters provide a full or favorable representation of the scope of the work carried on in the Territory. While the full costs of THQ and DHQ administration are included, there is no income or expense shown for any of the ministry units, so the level of administrative and fundraising costs always appears higher than reality, while the amounts spent directly on charitable activities appear lower than they should be. This results in incorrect conclusions being drawn regarding the size and scope of the Army's work, as well as how well it does in keeping administrative and fundraising costs low and maximizing the funds spent on charitable programs.

Consolidated financial statements will help resolve these problems and present a better picture of the Army's financial position and operations to donors, funding agencies and the public at large. That is the chief reason for pursuing the next phase of the project; however, there is a secondary reason that is also important.

Under Canadian accounting standards at present, while consolidation of controlled entities is required for not-for-profit organizations, there is an exemption that allows an organization to avoid consolidating controlled entities if there are a large number of them and they are individually immaterial to the overall financial statements. Since 1998, when the consolidation standard was introduced, this exemption has allowed the Army to avoid consolidation of ministry units; however, as Canada moves to converge with international accounting standards, it appears likely that this exemption will be removed. As a result, it seems prudent to work towards full consolidation even though it is not currently required.

I. WHAT DOES CONSOLIDATION MEAN?

Consolidation involves the incorporation of the financial statements of all units in the Territory within one set of financial statements to be issued by Territorial Headquarters. The resulting consolidated balance sheet will include the total assets, liabilities and fund balances of every unit in the Territory, and the statement of operations will include the total revenues, expenses, and surplus or deficit of every unit.

Transactions between individual units are eliminated so that there is no double-counting. For example, Red Shield funds are allocated from territorial to divisional headquarters and then to ministry units. In the consolidated statements, income would be recognized only once (i.e. as funds are raised in the National Red Shield Appeal), and funds spent would be recognized once (i.e. in the ministry units).

II. HOW WILL CONSOLIDATION AFFECT MINISTRY UNITS?

In order to accomplish the task of consolidation effectively, there will be a number of issues that local ministry units will have to address. This includes:

1. Accounting systems
2. Chart of accounts
3. Compliance with Generally Accepted Accounting Principles (“GAAP”)
4. Territorial accounting policies
5. Reporting on a consolidated ministry unit basis
6. Reporting deadlines
7. External audits

Each of these issues is discussed in further detail below.

1. Accounting systems

The task of consolidation will be greatly simplified to the degree that all units are using a common accounting system and chart of accounts. The Finance Department conducted some research to determine whether it would be timely to acquire a new system to be used across all operations in the Territory. This included consultation with other Territories to examine their systems and determine whether our Territory could benefit from work already addressed in other places.

Two key factors contributed to a decision to defer changing systems at this time, however. First, 85% of ministry units, both corps and social service centres, in the Territory are presently using the Shelby system, and it is generally not only meeting their current needs, but would be adequate to support territorial consolidation. Migration to the web platform would allow the Finance Department to carry out the consolidation task electronically, yet would involve minimal disruption for those units.

The task of converting 15% of ministry to a new system rather than 100% has obvious advantages for the successful implementation of full consolidation.

Second, the movement of Canadian accounting standards towards convergence with international standards is proceeding at a fairly rapid pace. There were concerns that if the decision was made to implement a new territorial system prior to proceeding with consolidation, the Territory could face a situation in which full consolidation would be required before it was possible for it to be implemented. Deferring consideration of a systems change to some later point in time allows the consolidation project to proceed on a timely basis to ensure that it can be accomplished prior to any requirement to consolidate being imposed.

Shelby Web is currently being used by all regional accounting centres, the Bermuda division, and in excess of 80 ministry units. Experience to date with this approach has been very positive. The Territory is implementing the Shelby Web system so that all ministry unit databases will be resident on a server at Territorial Headquarters. Ministry unit personnel will access their data over the internet. An internet connection is required, and while a high-speed connection is recommended, a dial-up connection will work reasonably, particularly for a smaller unit with lower volumes of transactions.

The plan is to convert all ministry units to the Shelby Web system in two phases. The first phase will be to convert the over 300 ministry units currently using the Shelby system to the Shelby Web by September 2007. This part of the project will be handled by the Information Technology Department, on a division by division basis.

The second phase will be for all other ministry units (except for those outlined in the next paragraph). This phase will convert the remaining ministry units to the Shelby Web system by April 1, 2008. The Finance and Information Technology Departments will work with divisional secretaries for business administration and local ministry unit personnel to ensure an orderly transition for these units, with appropriate training and support provided throughout the implementation phase.

Ministry units, such as hospitals, which are subject to government regulation over their choice of accounting and financial reporting systems, are exempt from the requirement to use the territorial standard accounting system. The Finance Department will work with these units to develop an appropriate template to capture information needed for consolidation purposes.

For those ministry units that have not yet acquired the Shelby system, a one-time license fee of \$995 U.S. is required and this amount will be billed by Territorial Headquarters at the date of implementation. There is also a periodic cost of approximately \$55 per user for the Microsoft Terminal Services access fee. This fee is charged whenever the server's operating system is updated, which at this point is estimated to be every 3 – 4 years.

2. Chart of accounts

A territorial chart of accounts is already in existence for the Shelby system and outlined in the Territorial Finance Manual. Over time, some units have adapted the chart to their own needs.

In order to ensure appropriate reporting for consolidation purposes, while still allowing sufficient flexibility for local internal or funding agency reporting requirements, the territorial chart of accounts will likely require some minor modifications.

Units that have made modifications to the territorial chart or developed their own chart of accounts will be required to convert to the revised territorial chart. The Finance Department will assist these ministry units in ensuring that local reporting needs can still be achieved effectively.

3. Compliance with Generally Accepted Accounting Principles (“GAAP”)

Most units in the Territory, other than those who already issue audited financial statements, follow what is essentially a cash basis of accounting. Under this model, income is recognized as cash is received, and expenses are recognized as cash is spent. Canadian Generally Accepted Accounting Principles requires organizations to use accrual accounting, which involves the recognition in the financial statements of revenue as it is earned, rather than when it is received. Likewise, expenses are recognized as they are incurred, rather than when cash is expended.

For example, if an invoice has been received from a supplier, under a cash system, no entry would be made until the invoice is paid, whereas the receipt of the supplies under an accrual system would result in an entry to reflect an expense in the appropriate category and set up accounts payable on the balance sheet to reflect the liability owed. Then later when the bill is paid, an entry would be made to reduce accounts payable and cash.

Another key change will be that units will be required to capitalize certain assets and amortize or depreciate their cost over their useful life rather than upon acquisition.

The Finance Department will be developing guidelines to assist ministry unit personnel in ensuring that their accounting is in line with Generally Accepted Accounting Principles, and staff will be available for consultation on an ongoing basis to assist units with questions of the appropriate accounting treatment for specific transactions they may encounter.

4. Territorial accounting policies

Consistent accounting policies will be required across the Territory for consolidation purposes. In most cases, ministry units will be able to adapt to territorial policies, if

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they are not already using them, with little or no difficulty. In other cases, the need to comply with a particular policy for funding agency reporting requirements may result in the need for a ministry unit make adjusting entries for consolidation purposes in order to adapt its financial statements to territorial policies. The Finance Department will provide guidance and assistance to local staff in this area.

For example, the current territorial policy for capitalization of equipment and furniture is that individual items with a cost of \$5,000 or more shall be capitalized and amortized or depreciated on a straight-line basis over their useful life. The following table shows the current required amortization periods for certain classes of capital assets:

ASSET	USEFUL LIFE
Audio/Visual Equipment	5 Years
Computer Equipment	3 Years
Clothing Banks	5 Years
Industrial Kitchen Equipment	10 Years
Office Furniture	10 Years
Owned Vehicles	5 Years
Owned Photocopiers	3 Years
Piano/Organ	15 Years
Renovations/Improvement - Interior (SA owned property)	20 Years
Restoration of Exterior Structure (SA owned property)	40 Years
Start-up Costs	Lower of lease term or 5 years
Tractors, and other similar items	5 Years

5. Reporting on a consolidated ministry unit basis

Ministry units will be expected to report to Territorial Headquarters on a consolidated ministry unit basis, which means that the unit will be required to issue financial statements that incorporate all of the activities and functions of the unit.

Currently, many units are not issuing consolidated financial statements. For example, many corps units maintain separate books and financial statements for each section of the corps (i.e. senior corps, young people's corps, band, songsters, etc.). For consolidation purposes, these sections will have to be consolidated within one financial statement that presents the overall financial position and results of operations of the entire ministry unit, irrespective of the fact that separate fund balances are being maintained by individual corps sections. The Finance Department will be developing guidance to assist units in consolidating their existing financial statements, while still allowing for internal reporting of individual sections or departments within the unit.

6. Reporting deadlines

In order to ensure that consolidated financial statements are issued on a timely basis, territorial standards will be established to govern when ministry units will be required to complete their accounting transactions for a year and submit financial reports to the

Finance Department at Territorial Headquarters. In addition, to assist the Finance Department in ensuring that units are complying with Generally Accepted Accounting Principles and territorial policies, interim financial statements and other reports will be required periodically throughout the year.

7. External audits

In order for the external auditors to express an opinion on the consolidated financial statements, they will need to develop an audit program that involves examination of the books and records of some ministry units.

Almost 100 ministry units in the Territory already undergo an external audit each year. It is not expected that the remaining units will require a full external audit, but the auditors will carry out certain tests and examine some records at a number of these units in order to be able to assess the overall consolidated financial statements. In other instances, they will be able to rely on information gleaned by the internal audit group at territorial headquarters in the course of their regular internal audit engagements.

In order to minimize the cost of the consolidated audit engagement, as well as to increase the efficiency with which it can be carried out, the Territorial Finance Council has determined that a single audit firm will be engaged to undertake all external audits of Salvation Army units in the Territory.

Units who currently require an external audit will be required to terminate the services of their existing auditor and engage the territorial auditor commencing with the engagement for the year ended March 31, 2008.

The firm of KPMG, LLP, Chartered Accountants, has conducted the territorial headquarters audits for the past six years. In order to ensure a smooth implementation of full consolidation, it has been determined that KPMG will now be engaged as the territorial auditor for both the consolidated audit engagement as well as to provide external audit services to any ministry unit that requires such an audit.

Once consolidation has been achieved, it is the Territory's intention to tender for audit services on a regular basis.

In order to ensure a smooth transition with existing audit firms, the Finance Department will be developing a communication package that ministry units may use to inform their existing auditors of this decision.

It is expected that the engagement of a single audit firm will not only reduce the overall costs to both territorial headquarters and ministry units associated with consolidation requirements, but will also result in reduced external audit costs for individual ministry units as a result of volume pricing that KPMG will provide. The Finance Department

will communicate with the affected units individually concerning this issue at a later date.

III. WHAT LEVEL OF EXPERTISE WILL BE REQUIRED?

It is recognized that the path to full consolidation will not be an easy one for all ministry units. While larger ministry units who have qualified staff will have no difficulty preparing their financial statements in compliance with Generally Accepted Accounting Principles and dealing with the other requirements that will be imposed, many smaller ministry units who do not have access to the expertise of a qualified accountant will find it a significant challenge to meet the requirements of presenting their financial statements in compliance with Generally Accepted Accounting Principles.

Some units may be able to meet the challenge with support from territorial and divisional headquarters. Others, however, will find that they are not able to do so, regardless of the level of support provided.

Some of these units may be able to address the situation through changes in staff or volunteers to engage those with the appropriate expertise. Other units will not be in a position to do so, either because they are unable to find individuals with the expertise required, or because they do not have the resources to engage such staff.

Such units may wish to consider using the services of a regional accounting centre to assist them in performing their accounting and financial reporting functions. Recognizing that cost could be a significant deterrent to small ministry units, the Territorial Finance Council has decided to make a special grant available to small ministry units to help offset or eliminate regional accounting centre fees.

Presently, RACs charge a fee for accounting services equal to 1.5% of the ministry unit's gross revenue. This fee has been determined to be a close approximation of the actual costs of providing RAC services. In looking for a solution to the fee dilemma for small ministry units, it was acknowledged that the Army's principle of "transparency" and "no hidden subsidies" would have to be maintained.

In order to assist small ministry units with the RAC fee, the Territorial Finance Council approved a grant to be made available to qualifying units, as follows:

- The grant is to be provided to any ministry unit with a total annual budget of less than \$300,000 that contracts with a regional accounting centre to perform its accounting and financial reporting functions.
- The grant is the lesser of the actual RAC fees paid by the unit or \$1,500 per year.
- The grant will be issued direct from THQ to qualifying units.

The result is that ministry units with total budgets up to \$100,000 will effectively have their accounting services provided by a regional accounting centre at a zero net cost. Ministry units with total budgets between \$100,000 and \$300,000 will receive a grant to offset their actual RAC fees, resulting in lower overall costs.

For example, a unit with a budget of \$100,000 would pay RAC fees of \$1,500 and receive a grant of \$1,500 for a net cost of zero. A unit with a budget of \$200,000 would pay RAC fees of \$3,000 and receive a grant of \$1,500 for a net cost of \$1,500. A unit with a budget of \$300,000 would pay RAC fees of \$4,500 and receive no grant. In other words, all ministry units with a budget under \$100,000 will obtain their accounting for free while units between \$100,000 and \$300,000 will receive a declining subsidy.

Existing RAC clients are eligible to receive a grant under these terms, commencing April 1, 2007. No application process is required. The Finance Department will automatically process these grants at that time.

Other units who are interested in obtaining the services of a regional accounting centre should be in contact with their divisional secretary for business administration and the regional director of accounting in their part of the Territory.

IV. HOW ARE MINISTRY UNITS TO KEEP INFORMED OF THE PROJECT?

Communication and education are critical to the success of such a significant project. The key elements of the Finance Department's communication plan for the project are as follows:

1. This discussion paper and invitation to comment In addition, the paper is also being posted on the Territory's Lotus Notes Noticeboard as well as on the Army's website, www.salvationist.ca, where comments may be posted electronically. Written responses submitted to the Territorial Financial Secretary by the comment deadline of November 15, 2006 will also be circulated to divisional secretaries for business administration and all those who have submitted comments. In addition, copies will be made available to any other interested stakeholder upon request.
2. A teleconference is being scheduled with divisional secretaries for business administration ("DSBAs") prior to the comment deadline to bring them up to date on the project. Their input will be solicited, as well as their assistance in circulating the discussion paper and encouraging responses from ministry units. DSBAs will also be asked to identify opportunities for direct interaction with corps finance local officers and finance staff at social services centres, either through teleconference or visits by senior Finance Department staff over the course of the next year.

3. A series of project updates will be published in *Salvationist* magazine and posted to the Lotus Notes notice board as well as to the www.salvationist.ca website throughout the course of the project. A Finance Department web page is being established (as part of the www.salvationist.ca website) for ongoing use as a part of a wider communications strategy to help connect finance personnel in ministry units with the THQ Finance Department.

4. A subscription based e-bulletin is being established for management and finance personnel throughout the Territory, to communicate issues related to the consolidation project, as well as other financial issues that arise from time to time. In some instances, detailed information may be provided in the bulletin itself, and in other instances, it may be more appropriate to provide a link to www.salvationist.ca where the information will be posted.

V. WHAT ARE THE TIMELINES FOR THE PROJECT?

A timeline for the completion of the consolidation project has been approved, as follows:

Target Event	Date
Response deadline for invitation to comment	Nov 15, 2006
1. Audit readiness guidelines issued	Sep 2007
2. Conversion of local Shelby users to Shelby Web	Sep 2007
3. KPMG to be retained as external auditor of all units	Mar 2008
4. Conversion of remaining units to Shelby Web*	Apr 2008
5. Trial consolidation for audit purposes	Mar 2009
6. Full consolidation	Mar 2010

* with specified exceptions.

VI. INVITATION TO COMMENT

The Finance Department encourages any stakeholder to submit comments on any dimension of the consolidation project. Respondents are asked to specifically comment on the following issues, as well as to supply any other comments they feel may be relevant in assisting the Finance Department in planning for the implementation.

1. Shelby Web is the new platform that is currently being introduced for ministry units to access their data over the internet. An internet connection is required, and while a high-speed connection is recommended, a dial-up connection is also suitable. Are there any ministry units that you are aware of that might have difficulty in converting to the Shelby Web platform by the published deadline? If so, what specific areas of concern would such a unit have?

2. Are there any ministry units that you are aware of that might have difficulty in switching to KPMG as their external auditor? If so, what specific areas of concern would such a unit have?
3. A standard chart of accounts currently exists, and is published in the Territorial Finance Manual (TFM). Are there any ministry units that you are aware of that are not using this standard chart? If so, what specific areas of concern would such a unit have in converting to the standard chart?
4. What steps would you like to see the Finance Department take in order to ensure a successful project completion (eg: training sessions, on-site visits, documentation or manuals/workbooks)?
5. As territorially consolidated financial statements require each ministry unit to consolidate their local data first, are there any ministry units that you are aware of that would have difficulty in completing this task (i.e.: consolidating all financial operations of the ministry unit (including all departments/sections) into a single statement)?
6. Other than the consolidation of local data, what are some of the other challenges your ministry unit has (or that you have heard about) related to consolidated financial statement preparation? How can the Finance Department help to address these challenges?

APPENDIX A
RESPONSES TO INITIAL INVITATION TO COMMENT
ISSUED IN SEPTEMBER 2005

The initial invitation to comment included 7 specific questions. There were a total of 19 respondents (6 divisional finance boards, 7 employees, 4 officers, 1 committee and 1 retired officer). A summary of their responses is given below:

Question (1) Are you in agreement with the decision to move towards full consolidation of ministry unit financial information in the territorial finance statements? If not, why not? **Responses:** There were 13 responses to this question, 12 in full agreement and 1 in conditional agreement.

Question (2) Do you support the adoption of a territorial chart of accounts?... **Responses:** There were 12 responses to this question, all in full agreement.

Question (3) Do you support the adoption of the Shelby system as the standard for accounting at all ministry units, subject to the proposed exceptions [*hospitals and health care centers where government regulations dictate the use of a specific accounting system*]? If not, why not? Are there any other exceptions that should be made? **Responses:** There were 11 responses to this question, 8 in full agreement and 3 with reserved agreement, none in disagreement.

Question (4) Do you support the proposed timeline for grandfathering units that are presently using Accpac or Simply Accounting [*of up to 5 years or at the time of the next software upgrade*]? If not, what alternative would you suggest? **Responses:** There were 11 responses to this question, 4 in full agreement, with the remainder supporting a shorter time frame.

Question (5) Other than those units noted in question #4 above, what period of time should be provided for existing ministry units to convert to the Shelby system? **Responses:** There were 10 responses to this question, with suggestions ranging from 6 months to 5 years.

Question (6) Do you support the idea of engaging a single audit firm as the best way to ensure cost minimization at all levels, as well as to help ensure timely issuance of consolidated statements? **Responses:** There were 12 responses to this question, 8 in full agreement, 3 in conditional agreement and 1 in disagreement.

Question (7) ... Do you see any reason why ministry units could not complete their year-end work, close their books, and be audited by the end of May? ... **Responses:** There were 10 responses to this question, 7 in full agreement (that there were no reasons for ministry units not meeting the May deadline), 2 in conditional agreement and 1 in disagreement.