THE SALVATION ARMY
CANADA & BERMUDA

TERRITORIAL CONSOLIDATION YEAR END PROCESS
March 31, 2013
Audited Units

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INTRODUCTION AND PURPOSE

March 31, 2013 marks the end of another fiscal year and it is fast approaching. Now is the time to prepare for year end to ensure financial information is accurate, complete, consistent, in line with current Territorial policies, and in accordance with Canadian accounting standards for not-for-profit organizations. Consolidated financial statements for the territory is one of the main documents that allow public donors, funding agencies, potential donors and others to obtain an accurate and complete picture of the scope and ministry of Salvation Army operations in Canada and Bermuda. The successful preparation of this inclusive document involves the cooperation, hard work and dedication of many individuals throughout the organization.

This guide has been prepared to assist you in preparing for the year end external audit and territorial consolidation process and will:

a) describe the tasks and the timelines we must meet to issue consolidated financial statements,
b) provide guidance on preparing for year end, highlighting consolidation and various accounting issues,
c) provide procedures for closing year end,
d) provide an overview of the specified audit procedures performed by KPMG if required,
e) provide details of the audit process.

We urge you to plan ahead and have procedures in place at your ministry unit to meet the required tasks and deadlines.

TIMELINE

Consolidated financial statements are required to be timely in order to be useful to readers. Our deadline for issuing financial statements is early July, with approval by the Governing Council on June 26, 2013. In order to meet this deadline, the timeline provided in Appendix 1 must be adhered to. Any delays in the schedule may cause serious setbacks.

Over the next couple of months, all ministry units must develop a plan for closing the year according to the attached schedule. If you have any concerns or expect any problems meeting the timeline, please contact the consolidation team immediately (THQ_Consolidation@can.salvationarmy.org), so we can provide support to ensure we stay on schedule.

YEAR END PREPARATION

Chart of Accounts

Consolidation relies heavily on accurate recording of ministry unit transactions, using the standard chart of accounts published in the Territorial Finance Manual. Account categories and groupings presented in the consolidated financial statements are based on this structure. It is vitally important that all ministry units adhere to the standard, ensuring all accounts are appropriately classed and categorized. In particular:

- Ensure department numbers you assign comply with territorial standard. For example:
  - based on the program type , all operating departments range from 200-899, and
  - all restricted departments/funds must fall in the 900-999 range.
- Verify all government funding is recorded in the income account range (611700-611799) including:
  - Lump sum government grants,
  - Per diem government funding,
  - Monthly reimbursements from the government,
  - Any payment received from the federal, provincial or municipal government.
- Make sure expenses are classed within the correct account ranges:
  - personnel,
  - general operating,
  - program,
  - equipment and property,
  - grants and allocations.
- Ensure inter-company transactions are recorded in the designated accounts.

Review your account structure to ensure all accounts are classified correctly and in accordance with the standard chart of accounts, which is attached in Appendix 2. Please note updates are made periodically to the standard chart of account throughout the year so it is important to review the current structure to ensure any discrepancies are corrected before the books are closed.

Accounting Transactions

Vacation Accrual

The vacation accrual represents an employer's liability with respect to vacation earned by employees, but not yet paid as of March 31, 2013. All ministry units must record or update this liability prior to closing the books. To assist you with the calculation of the accrual, please refer to Appendix 3, which is a template that can be used to track vacation entitlement and calculate the required year end liability.

If a union contract exists where the employee vacation entitlement differs significantly from territorial policy, you will need to review the terms of the contract and calculate the appropriate liability.

The vacation accrual journal will be recorded as follows:

If the amount calculated is higher than the current balance in the vacation accrual liability account:
Debit   ddd/71XXXX Salary Expense $ X
Credit 000/215900 Vacation Accrual $ X

If the amount calculated is less than the current balance in the vacation accrual:
Debit 000/215900 Vacation Accrual $ X
Credit   ddd/71XXXX Salary Expense $ X

Where ddd represents the operating department to charge (will be the same department the employee's salary is charged to), 71xxx represents the salary expense account and $X represents the difference between the calculated vacation accrual this year versus what is currently recorded in the vacation liability account.

The vacation accrual is a reflection of the on-going liability the employer has with respect to vacations and therefore is to be listed on the ministry unit's balance sheet throughout the year (i.e. no reversal is required in the following month). The liability balance will remain static throughout the year, but will be adjusted at year end through the calculation and entries outlined above.

<u>Other Accruals</u>

Prior to closing the general ledger, appropriate accruals must be made for all expenses and revenues. That is, ensure all revenue and expenses have been recorded if they have been earned or incurred as of March 31, 2013, even if the cash is received or paid in April. Any goods received but not paid for at the end of the accounting period become liabilities; while revenue earned but not received become receivables. The purpose of an accrual is to recognize expense or revenue in the correct accounting period.

A separate accrual journal entry may not be required if the accounting transaction has been recorded to the appropriate accounting period through the regular accounting process. For example, vendor invoices with a March date may be entered during the first few days of April, but posted to March when saving the invoices in the accounts payable (AP) system.

If expenses / revenues have not been recorded to the correct accounting period through the normal accounting process (Accounts Payable or Accounts Receivable system), then a journal entry will be required to ensure revenue and expenses are accrued correctly.

The following process should be followed to accrue expenses. The same process should be followed to accrue revenue; however the accounts used would be receivables (debit) and revenue (credit) rather than expense and payables, respectively.

Process:

At year end, use a quote, subsequent invoice or another appropriate calculation technique to estimate the expense to be recorded. Then book the following journal entry in March:

Debit ddd/7XXXXX Expense $ X
Credit 000/219000 Other payables and accrued liabilities $ X

In most cases, when manual accrual entries are made, a reversing entry will be booked in the following accounting period. The reversing entry will be the exact opposite of the original entry. Using reversing entries simplifies the accounting process, as it allows vendor invoices and cash receipts to be processed through the normally accounting processes the following month, without consideration to what was previously accrued.

In this case, an entry will be booked in April (new fiscal year) as follows:

Debit 000/219000 Other payables & accrued liabilities $ X
Credit ddd/7xxxxx Expense $ X

It is important to use an accurate calculation when accruing because if the difference between the actual and estimate is too large an audit adjustment will be required. It is extremely important to review all subsequent invoices and cash receipts received after March 31, to ensure appropriate accruals are recorded. There will be at a minimum an accrual for auditing fees, salaries, vacation and management support assessment.

Posting to fund balance accounts

Direct postings to fund balance accounts (4xxxxx) must **not** occur at any time. In other words, the opening balances as of April 1 in the 4xxxxx series accounts should be unchanged throughout the year. With full consolidation, fund balances must roll from one year to the next, meaning the closing balances for 2012 must tie to the opening fund balances for the 2013 fiscal year. Please review all fund balance accounts to ensure no postings have been made to them directly. There may be some exceptions, but these have already been communicated directly to the affected ministry unit.

Capital Assets Review

It is important to maintain an inventory of capital assets which have been recorded on the balance sheet. At any point in time, the capital asset value must reflect assets in service. If an asset has been disposed of or is no longer in service, it must be removed from the balance sheet. In addition, the net book value of fixed assets must tie to the closing invested in capital fund balance. The most common reasons for discrepancies are:

1. the depreciation expense was not recorded to department 940,
2. the amount for any additions was not transferred to department 940 from the department that funded the purchase.

Gift in Kind Revenue

All amounts recorded as gifts in kind must be supported by third party evidence that is readily available for review. The amount cannot be simply estimated by the ministry unit, unsupported.

The most common example of gifts in kind relate to food donations. If a grocery store donates a large volume of food which will be recorded as a gift in kind, the ministry unit must request the grocery store to provide some back-up of how the value of the goods can be determined. If this is not available, the ministry unit cannot issue the grocery store a charitable receipt and the amount cannot be recorded as revenue.

As a rule of thumb, do not record gift in kind donations unless you have appropriate back-up to issue a charitable receipt (regardless if the receipt is issued). Without appropriate support, audit opinions will be qualified, which we do not want associated with our financial reporting. If unsupported amounts are currently recorded, reverse all entries prior to closing the books.

Intercompany Transactions

The consolidation of financial statements requires the elimination of:

1. all income received by a ministry unit from a related party (THQ, DHQ, other MU) against the corresponding expenses recorded by the related party, or alternatively any expense recorded by the ministry unit that is recorded as revenue by the related party,
2. any internal receivables and payables,

Common examples of the above include:

- red shield allocations,
- DHQ/THQ grants,
- THQ/DHQ interest,
- MSA expenses and
- receivables or payables to THQ/DHQ.

Eliminating these transactions ensures the financial statement categories are not overstated. It is critical to record intercompany transactions correctly as the consolidation team must reconcile each elimination entry. Posting transactions to the incorrect accounts does make reconciliation very difficult.

Appendix 4 provides a description of all intercompany accounts and how to review each of them to ensure balances are accurate. **Reviewing all intercompany accounts prior to closing the fiscal year is extremely important.**

To assist with the reconciliation of intercompany balances, there are to be **no** cheque payments between related parties (THQ, DHQ and ministry units) between March 23 and March 31, the last week of the fiscal year. This will help to ensure amounts shown as receivable in one unit's books will match the payable shown in the related party's books. Without the early cutoff at the end of March, there would be many situations where the payable would be eliminated in March, but the offsetting receivable would not be eliminated until April, when the cheque is received and cashed by the related party.

Supporting Documentation

Funding and Lease Agreements

It is important to maintain a file that contains ***ALL*** signed funding and lease agreements, including any subsequent revisions. All revisions received via email should be saved in a separate file and include with the original document. When revising contracts with funders or landlords, ensure you have written support for any changes made. Avoid verbal agreements, as these are difficult to track and will make the audit process extremely difficult.

Support must be current and be provided to the auditors on the first day of field work. Non-audited ministry units must have this file on hand in the event it is requested as support for the audit of the consolidated financial statements.

Accounting Records

All accounting records and supporting documentation (bank statements, invoices, receipts, audit reports, etc.) must be organized and filed at all times. If questions arise as part of your audit or the consolidation audit, you **must** be able to access the information easily and quickly.

YEAR END CLOSING PROCEDURES

In order to meet the timeline for consolidation it is important to have procedures in place to allow the process to run efficiently and effectively. The following will discuss key procedures and controls that should be implemented.

1. *Cut-off Date*

   After March 31st (March 22nd for related party invoices), no payments (issuance of cheques – CD batches) should be recorded in the year ending March 31, 2012. All invoices received after this date relating to the prior year should be recorded in accounts payable or accrued with the payment recorded in the year beginning April 1, 2012. Note, if the invoice is dated after March 31st, it should be expensed in the following year and not accrued in the financial statements.

   A cut-off date for when invoices are recorded in accounts payable should be established. Any invoices not received by this date, but expected, should be accrued as outlined previously.

2. Account Reconciliations

Once the cut-off date has passed and all transactions have been posted, account reconciliations or a detailed account analysis should be prepared for each balance sheet account. This includes, but is not limited to, the following (see Appendix 5 for a detailed listing):

- preparing a bank reconciliation,
- verifying all deposit accounts and related fund balances tie to DHQ/THQ's records,
- confirming accounts receivable, accounts payable and fixed assets tie to their respective sub ledger control account or asset listing,
- reviewing all accrued balances to determine if the amount is appropriate and can be substantiated,
- determining if deferred revenue balances are appropriate.

3. Variance Analysis

After the financial records are finalized, but before the books are closed, management should review the financial statements in detail. This includes reviewing the balance sheet and detailed statement of operations, in its entirety. This review should include preparing a variance analysis that compares the year-to-date actuals to both budget and prior year actuals. Any variances that cannot be explained can be indicative of a posting error and should be researched to determine if there has been miscoding or another error that requires an adjustment.

4. Reconcile Shelby to the Audited Financial Statements

Once final audited figures are available, a reconciliation must be performed to ensure figures reported in the audited financial statements tie to the account balances reported in Shelby. Any necessary adjustments must be posted to Shelby no later than May 24, 2013. As part of the consolidated financial statement audit, KPMG will be verifying the financial data pulled from Shelby for consolidation purposes tie to the audited statements. Failure to enter audit adjustments will result in differences and may delay the issuance of the consolidated financial statements.

5. Run the Closing Procedures in Shelby

Once the financial records have been finalized and approved by management the closing procedures in Shelby should be run. By running the closing procedures the default year in Shelby is updated to the fiscal year beginning April 1, 2013 and the March 31, 2013 year is locked. This will prevent incorrect postings between the two fiscal years.

SPECIFIED AUDIT PROCEDURES

Summary financial data for all ministry units is provided to KPMG in advance of the year end audit. Based on KPMG's review of the financial information received, ministry units <u>may</u> be selected by the auditors to undergo some audit testing in order to gain further assurance on the financial data that will be disclosed in the consolidated statements for the territory.

The ministry units selected for these procedures will be individually contacted and provided details of the nature, timing and extent of what is required, however, a general overview is provided in Appendix 6. In most cases, testing will be performed at THQ. Ministry units will be required to scan backup documentation and send it to THQ and be available to answer auditor queries as they arise (vacation time must be avoided until the audit is complete).

The ministry units selected for these procedures will change from year to year; therefore the information provided in Appendix 6 is useful for all readers.

AUDIT PROCEDURES

In order to achieve the deadline all external audits must be scheduled to commence the week beginning April 29, 2013. If you have not already done so please contact your local auditors to schedule the audit for this time.

Vacations must be avoided during the audit season as you will be required to answer specific questions related to ministry unit operations. All audit queries must be answered promptly to ensure the May 22nd deadline for issuing final audited statements is met.

Prior to the auditors' arrival all documents requested in the Prepared by Client (PBC) Listing should be completed, reviewed by management and readily available. This includes but is not limited to account reconciliations, signed agreements, variance analysis and draft financial statements, with supporting note disclosures.

Financial Statement Preparation

Accounting Standard Changes

Accounting standards have changed from last year and The Salvation Army is required to present the financial statements in accordance with Accounting Standards for Not-for-Profit Organizations (Part III of the newly revised CICA Handbook). All implemented changes have been reviewed at Territorial Headquarters and there will be no impact to the accounting at ministry units. Many of the changes that were implemented will only impact the accounting performed at the territorial level.

While there is no accounting impact locally, there will be changes made to the presentation of the audited financial statements for March 2013. Upon adoption of the new standards, ministry units must present the balance sheet as of the transition date (April 1, 2011), which is the beginning of the earliest period for which comparative numbers are presented, along with the regular two year comparatives. This means ministry units must present the balance sheet as of April 1, 2011, March 31, 2012 and March

31, 2013. This reporting is required even though there will be no restatement of any financial figures. Any note disclosure on balance sheet items will require the three year comparative numbers shown. The financial statement template included in Appendix 7 will provide you the format that will need to be followed. Please note there have been some additions to the preamble, policies and notes to the financial statement to disclose the change in the standards.

Financial Statement Presentation

You are required to prepare complete and accurate financial statements in their entirety, which includes the balance sheet, statement of operations, cash flow statement and supporting note disclosure. Not doing so will drastically increase the audit fee, as KPMG will bill for any time spent to prepare statements and provide additional accounting support. This requirement has been communicated to KPMG so they can budget their audit time accordingly. Any previous arrangements for auditor's assistance are not provided for in the audit fee quoted.

In order to ensure all ministry units are adequately prepared for the external audit, a standard financial statement and notes template has been prepared and can be found in Appendix 7. In order to achieve consistent reporting throughout the territory it is important to follow the standardized wording provided. This template is meant to be a guideline and may not be inclusive of all required disclosures needed to suit local reporting requirements. Additional disclosures must be added as deemed necessary. In addition to the template, a copy of the 2012 note disclosures should be obtained from your local auditors in a Word document to provide you with a starting base.

The consolidation team requests all ministry units to draft a full set of financial statements as of December 31, 2012 and provide them for review to the team no later than **February 15, 2013**. Once completed these should be emailed to THQ_Consolidation@can.salvationarmy.org. The purpose of this exercise is to ensure all ministry units have the expertise to complete the task effectively as well as alleviate some work at year end, as all prior year figures, wording and major issues will be corrected and finalized well before March 31, 2013 and the commencement of the audit.

Audited Financial Statements

At year end, the THQ Finance department must review financial statements before they are issued as final. Once you receive final draft statements from the auditors, send them to Justin Yantha (Justin_Yantha@can.salvationarmy.org) and David Dunstan (David_Dunstan@can.salvationarmy.org), with a copy to the local auditor. You can issue final audited statements only after they are reviewed by the finance department and recommended changes are implemented. All audited statements **must** be completed and finalized by **May 22, 2013**. Please target **May 17 or earlier** to send final draft statements to the finance department to allow time for their review. Once the finalized draft is sent to THQ the reconciliation between Shelby and the audited financial statements, discussed above, should be completed.

After the Management Representative Letter is signed by local management and provided to KPMG the final audited statements will be issued from KPMG's offices and include two signatures from Governing Council members, so they can be sent to funding bodies immediately.

Audit Fee

Please note that the audit fee will be invoiced by the local KPMG office **directly to the ministry unit**. It will be the ministry unit's responsibility to remit payment for the invoice. KPMG has been informed that any issues arising from the audit that will require extra billing must be fully discussed and fee negotiated with local management. Any disagreements on the extra billings must be resolved locally. Any additional fees charged are the responsibility of the ministry unit.

NEED ASSISTANCE?

If you have any problems or have any questions regarding the year end process, please contact the consolidation team (THQ_Consolidation@can.salvationarmy.org). We will be pleased to provide you with clarification or assist you in any way we can.

Your cooperation and hard work in meeting these deadlines is much appreciated.