

The Local Church Audit

Why would a local church want an audit? Here are a few:

An audit is the best way we (and the General Conference) know of

- to protect the persons the local church elects to offices of financial responsibility from unwarranted charges of careless or improper handling of funds;
- to build the trust and confidence of the financial supporters of the church in the way their money is being accounted for (trust and confidence lead to improved patterns of financial support);
- to set habits of fiscal responsibility to assure that when there is turnover in personnel there will be continuity in accountability and nothing will fall through the cracks;
- to assure that gifts made to the church with special conditions attached are consistently administered in accordance with the donors' instructions, and thus let donors know their gifts are used as intended;
- to provide checks and balances for sums received and expended. Conducting an audit is not a symbol of distrust.

It is a mark of responsibility.

It is good stewardship demonstrated for all to see.

It is a message to local church donors that you care about their gifts.

In the definition of a local church audit, what does "independent" mean?

"Independent" means that the auditor must not be subject to control or influence by anyone who has responsibility for the financial accounts and records of the local church. There should not be even the appearance of a relationship that may dilute the perception of the independence of the auditor.

Can you outline just what an audit does?

For starters, an audit should:

- Independently verify the reports of the treasurer(s);
- Follow the money and test how it is treated at different steps;
- Document that donated and earned funds of the congregation have been used as stipulated by the donors.
- In addition to tracking the cash through the system, an auditor typically will evaluate:
 - Accounting controls (systems that reduce the possibility of loss or errors);
 - Segregation of duties (assurances that more than one person is involved in critical steps in handling money so that there can be checks and balances);
 - Reasonableness of systems and procedures in the light of all factors, including the size of the church and its budget;
 - Systems for retaining and accessing meeting minutes that have financial implications (i.e., Finance Committee, Church Board); and
 - Records that show donors' stipulations for the use of gifts made to the local church.

A local church's unique circumstances may suggest that additional steps should be taken. It is important to document the financial processes of your particular local church.

What kind of information does an auditor need to look at?

The person(s) or the auditing firm must obtain access to the following information and materials: Copies of all church policies and procedures related to finance and treasury functions and copies of minutes approving those policies.

Copies of all the minutes from the finance committee, the trustees, the administrative board, the previous charge conference(s), and the other entities listed on the prior page.

Listing of all bank and investment accounts, including the person authorized to sign on each, and including any special use accounts under the control of the pastor(s) and in the name of the church.

- All financial statements for each month of the year.
- Bank reconciliations for that same period.
- The general and subsidiary journals; for those books that are computerized, a print-out of all transactions by account for the entire year.
- All paid invoices, payroll data and files.
- Financial records and other income records for the same period.

What about confidential information?

The person(s) conducting the audit may obtain access to confidential information and must treat that information accordingly. The auditor's work papers may contain confidential information.

These work papers as well as all financial records should be retained for at **least seven years** in a secure, limited access, storage area.

How does the local church auditor get bank confirmations?

For each bank and investment account, the auditor requests the balance as of the last month of the audit. **Addendum III** is a standard form for obtaining this information.

Disbursements?

Reviewing the Finance Committee, and other committee minutes, as appropriate, for actions concerning disbursements, including apportionment payments. Reconcile those actions with any actual payments made.

- Test to ensure that all of the disbursements have been properly authorized.
- Review the original books of entry and disbursements journal to ensure that all disbursements have been recorded appropriately.
- If there is a purchase order system in conjunction with disbursements, note whether the purchase orders have been authorized and approved by the appropriate person(s) and matched against the actual disbursement or invoice.

Control system?

As part of the audit, it is essential that the internal control structure for receipts and disbursements procedures be reviewed regardless of the size of the church. The internal control structure is the process that assures the local church's *operational* efficiency and effectiveness, that its financial reporting is reliable and that its assets are safeguarded. The internal control process should be in place not just on paper but in actual operation.

Areas of concern that should be evaluated include:

1. Segregation of duties.

It is important that duties be segregated among two or more persons, if possible. We understand

that in very small churches this may be difficult, but it is rarely, if ever, impossible. The effort by small churches is to attain reasonable segregation under all the circumstances. Here are some examples. The financial secretary and the church treasurer(s) should not be related. These should be separate offices occupied by different individuals, who are not related by blood, marriage or employment relationships. Also note that at least two persons should count the morning collections and they should not be related to each other nor should either one be the financial secretary or church treasurer. Receipt and disbursement functions should be performed by different people. (This may not be possible in small churches but is desirable.)

2. Authorizations for disbursements.

The first point is that everyone who approves disbursements must be authorized to do so. The auditor should look for resolutions and action in the minutes of the finance committee and the governing body that address authorizations.

The check signer should not be the authorizer of expenditures or the person who performs bank reconciliations. The auditor should examine the checks to determine who is signing and compare the results found to bank authorizations.

3. Finance reports.

Monthly Finance and Treasurers reports should agree with the general ledger and subsidiary journals. Balances as of the first day of each month should be same as the last day of previous month.

Are investments made only by authorized persons?

Are transactions recorded in the correct year?

Are checks and cash stored in the church safe, deposited or placed in a bank night depository, and not taken to private homes or elsewhere until deposited?

Are computer software and data files backed up on a regular basis, and are back-ups kept off the premises?

Do all appropriate persons have a clear understanding of and is there documentation on church ownership of software and data files?

Are reports from the treasurer to the finance committee accurate, timely and complete enough to provide necessary information for the committee to make prudent decisions?

Is the finance committee providing to the church board sufficient information to allow it to exercise its fiduciary duties; are members of the finance committee and the governing body free to express opinions and to question management when appropriate?

The audit is complete when the auditor is reasonably assured that the financial records are in order, financial policies have been complied with and any discrepancies have been investigated and controls have been reviewed. With that assurance, the auditor is ready to prepare the Report of the Audit for the church board and conference. Finally, the auditor should offer to meet with the church board to discuss the audit, and should assure that the audit report, with any responses the finance committee may choose to add, is delivered to the conference.

Is the auditor's work finished yet?

Once the auditor has delivered the audit to the conference, the audit process is finished. One final word of caution, though.

If the auditor meets with the church board.

Although church meetings are generally open to all, discussions about matters involving

personnel issues may be held in closed meetings if confidential information is likely to be disclosed. An example would be if there is suspicion that someone has made off with church assets. Suspicions should not be discussed in open meetings. Closed meetings will include only the members of the group that is meeting, plus any invited guests, such as the auditor or the church's legal advisor. The group should be aware of the manner in which closed meetings must be reported. And now the audit is finished until the next audit.

How and when is the Audit Report prepared?

CHECK OFF LIST

- ✓ Reconciliation of Bank & Investment Accounts
- ✓ Are Bank Accounts Balanced Monthly
- ✓ Verification of Beginning and Ending Balances.

BANK & INVESTMENT

- ✓ Account balances confirmed by Bank/Company

INCOME

- ✓ Two unrelated persons counting
- ✓ Timely deposit of funds
- ✓ Transmittals checked against deposits
- ✓ Transmittals checked against postings to GL
- ✓ Confirmations sent to donors
- ✓ Differences researched & cleared

DISBURSEMENTS

- ✓ Invoices properly approved
- ✓ Check number and date noted
- ✓ Purchase order system, if applicable, working
- ✓ Accounts to charge noted on invoice
- ✓ Any invoices to vendors over 30 days in arrears
- ✓ Interest & service charges recorded
- ✓ Verification of checks at random
- ✓ Procedure in place to distribute gifts on a regular basis
- ✓ Designated gifts paid out timely

REPORTS

- ✓ Do reports provide complete picture
- ✓ Are reports helpful to committee members?
- ✓ Are there controls for over expenditures?
- ✓ Restricted Funds used according to policy
- ✓ Regular reports to finance committee and pastor

GENERAL LEDGER

- ✓ Internal controls for disbursements reviewed
- ✓ Other asset accounts reviewed (equipment, buildings, contracts, etc.)

- ✓ Accounts Payable reviewed
- ✓ Accounts Receivable reviewed

**WHAT TO EXPECT FROM A FINANCIAL REVIEW
TO ANSWER A LOT OF QUESTIONS SUCH AS:**

1. HOW ARE CASH RECEIPTS HANDLED
2. WHEN DO YOU ISSUE RECEIPTS
3. WHO CAN SIGN CHECKS
4. DO YOU HAVE A PAYROLL OR DO YOU USE THE CONFERENCE
5. ARE ALL YOUR FUNDS AND BANK ACCOUNTS SHOWING ON THE FINANCIAL STATEMENTS
6. DO YOU HAVE INVESTMENTS

A REVIEW OF THE FINANCIAL STATEMENTS SUCH AS:

1. COMPARISON BETWEEN PERIODS
2. COMPARING INCOME TO STUDENT COUNT OR MEMBERSHIP
3. LOOKING AT SUPPORTING DOCUMENTATION SUCH AS:
4. BANK RECONCILIATIONS
5. INVOICES PAID
6. CANCELED CHECKS
7. TITHE ENVELOPES TIED TO DEPOSITS
8. BANK STATEMENTS & BROKER STATEMENTS
9. LOAN DOCUMENTS
10. BOARD MINUTES
11. A REPORT FROM THE AUDITOR WITH A REVIEW OPINION AND LIST OF FINDINGS WITH RECOMMENDATIONS
12. BOARD MINUTES

HAVE THE FOLLOWING ITEMS AVAILABLE FOR THE REVIEW

1. YEAR TO DATE FINANCIAL STATEMENTS THAT WERE GIVEN TO THE BOARD
2. LIST OF CASH DISBURSEMENTS INCLUDING CHECK #'S
3. INVOICES PAID AND A WAY TO TIE IT TO CHECKS WRITTEN
4. CANCELED CHECKS OR COPIES OF CANCELED CHECKS
5. TITHE ENVELOPES
6. DEPOSIT SLIPS TIED TO TITHE ENVELOPES
7. BANK STATEMENTS
8. BANK RECONCILIATIONS
9. PAYROLL RECORDS IF YOU DO THE PAYROLL INCLUDING TAX RETURNS
10. INVESTMENT BROKERS STATEMENTS RECONCILED IF APPLICABLE
11. LOANS PAYABLE DOCUMENTATION