

Safeguarding the Financial Assets of Your Church

Indiana Conference of the
United Methodist Church



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1. General

Purpose of this guide: This information is intended to be used as a supplement to your church audit for members of the financial committee within your church. The Indiana Conference recommends reviewing the information contained in this guide and incorporating it into your financial review. Pastors and church financial officers need to “set the tone at the top” for ethical behavior in an organization. They must show the congregation through their words and actions that dishonest or unethical behavior will not be tolerated. Additionally, it should be evident that everyone will be treated equally, regardless of their position. Churches should be proactive in reducing fraud opportunities by (1) identifying and measuring fraud risks, (2) taking steps to mitigate identified risks, and (3) implementing and monitoring appropriate preventative internal controls and other deterrent measures.

Reasons for an audit: An audit is “the best way for a local church to protect those persons it elects to offices of financial responsibility from unwarranted charges of carelessness or improper handling of funds. It is not a symbol of distrust” (*Local Church Audit Guide*, p 4, United Methodist Church). In addition, church committees, treasurers, finance committees, and other persons in positions of responsibility are liable for any losses which would have been discovered by an ordinary audit but were not discovered because they failed to have the audit conducted.

The complexity of fraud schemes is one reason for the Indiana Conference’s recommendation that an annual audit is conducted, when feasible, by a certified public accountant in addition to having the internal audit done.

2. What Are the Advantages of Having an Audit?

An audit accomplishes several important functions:

- An audit promotes an environment of accountability in which opportunities for embezzlement (and therefore the risk of embezzlement) are reduced.
- The audit will provide the church leadership with information that points out weaknesses and inefficiencies in the church’s accounting and financial procedures. This information is invaluable to church board members.
- An audit contributes to the integrity and reputation of church leaders and staff member who handle funds. It is less likely that church leaders will be accused of financial mismanagement.

- An audit gives donors and members a greater assurance of financial integrity and accountability.

3. Review and Assessment of Internal Controls

The internal control structure consists of the church's policies, procedures, and commitment to reasonably prevent material errors and irregularities from occurring or going undetected. Internal control can be described as the overall plan of the church and the methods employed by the church to safeguard assets, ensure the reliability of the accounting data, encourage compliance with established procedures, and promote efficient operations. Good internal controls provide greater assurance that transactions are recorded properly. The review of the control system must be done in order to assess the risk that the financial statements are materially misstated. Thus, if the controls in a particular area are bad, the risk that the account is misstated is higher and more testing in this area may be merited.

An internal control questionnaire is a good way to begin the review process. The questionnaire below is intended to provide guidance to evaluate the existing system in place at your church. The normal answer is "yes". However, a "no" answer does not necessarily mean that the church is unauditible or that the control environment is effective. It may simply suggest an area of the system that could be strengthened. The following questions will help your church identify areas of weakness that could be exploited

Internal Control Questionnaire

Background:

1. Are prior internal control questionnaires available?
2. Have recommendations of prior reports on internal controls been implemented?
3. Is a complete and current chart of accounts, listing all accounts and their respective account numbers, available?

Budget: The development and use of a budget is a critical management tool that will aid in the stewardship and administration of church resources and program.

1. Is the budget approved by the church?
2. Are all changes to the budget authorized by the church committee and recorded in the minutes of the meetings?
3. Is there a periodic review of the budget by the church committee?

Financial Statements:

1. Are monthly financial statements prepared on a timely basis and submitted to the church board or appropriate person or committee?
2. Do the financial statements include all funds (unrestricted, temporarily restricted, and permanently restricted)?
3. Are account balances in the financial records reconciled with amounts presented in financial reports?

Reporting: The best accounting system is of little value unless the information is communicated to those responsible. Although there may be variations, there are certain minimum standards to assure adequate communication of the financial information.

1. Is a Treasurer's report submitted to the church committee or finance committee each month?
2. Is the Treasurer's report presented in sufficient detail to inform the reader as to the nature of the various items of income and disbursements?
3. Does the report present the current actual financial data compared with the approved budget?
4. Is there periodic reporting, at least quarterly, of all other funds and activities, including designated or restricted funds?

Cash Receipts: Clearly stated policies and procedures regarding the handling of cash receipts help not only to protect from loss, but assures that all receipts are properly recorded in the records.

1. Are there safeguards to protect the collections from theft or misplacement from the time of receipt until the time the funds are counted and deposited?
2. Do we place offerings in lockbags (money bags provided by the bank requiring a key to open) after counting? Do we place the lockbags in a safe until the bank opens?
3. Are the collection receipts counted and deposited so that the deposit equals the entire amount of receipts on a timely basis, i.e., at least weekly?
4. Are there at least two unrelated persons responsible for the counting and depositing of the collections?
5. Are the persons responsible for counting receipts rotated on a periodic basis?
6. Do the counters have a standardized form for recording the deposit information?
7. Are the counter's sheets retained and reconciled with actual deposits, and are all discrepancies investigated?
8. Is the cashing of checks out of the currency received prohibited?
9. Are third party checks returned to donors?

10. Are all of the pledge envelopes or other memoranda retained and reconciled to the recorded amounts?
11. Are all other cash receipts recorded and deposited on a timely basis?
12. Are all checks received restrictedly endorsed "for deposit only" immediately upon receipt?
13. Are there procedures, which will highlight, or bring to someone's attention, the fact that all receipts or income have not been received or recorded?
14. Are periodic statements provided to donors of record, i.e., at least quarterly?
15. Are all discrepancies investigated?

Cash Disbursements: The following procedures will assist in assuring that all payments are properly approved, recorded, and supported by appropriate documentation.

1. Are all disbursements made by check, except for small expenditures made by petty cash?
2. Are all checks pre-numbered and used in sequence?
3. Is there a clearly defined approval process for all disbursements?
4. Are all voided checks properly canceled and retained?
5. Are all checks made payable to specified payees and not to cash or to bearer?
6. Are all disbursements supported by original documentation?
7. Is the original vendor's invoice or other documentation canceled at the time of signature to prevent duplicate payment?
8. If a petty cash fund is used, are vouchers prepared for each disbursement from the fund?
9. Are all disbursements requiring special approval of funding sources or of the church committee properly documented in the Church committee or Finance Committee minutes?

Check Signing:

1. Is the signing of blank checks prohibited?
2. Is the use of a signature stamp or preprinted signatures prohibited?
3. Does all supporting documentation accompany checks presented for signature?
4. Are all account signers authorized by the church?
5. Are all person authorized to write checks against church funds held responsible through an accounting/auditing system?
6. Is more than one signature required for any check?
7. If not, do checks for more than \$500 require more than one signature?
8. If signature imprint machines are used, are the key kept under lock and key except when in use?

Petty Cash Funds

- Is a petty cash fund used for disbursements of a small amount? If so, is the fund periodically reconciled and replenished based on proper documentation of the cash expenditures?

Bank Statement Reconciliation

- Are written bank reconciliations prepared on a timely basis? Are the bank reconciliation reports signed and dated?
- Are there any checks that have been outstanding over three months?

Savings and Investment Accounts

- Are all savings and investment accounts recorded in the financial records? Compare monthly statements to the books.
- Are earnings or losses from savings and investment accounts recorded in the books?

Accounts Payable

- Is there a schedule of unpaid invoices including vendor name, invoice date, and due date?
- Are any of the accounts payable items significantly past-due?
- Are there any disputes with vendors over amounts owed?

4. Safeguard the Church Treasury

Controls on Expenses

Three elements are key to controlling the disbursement of church funds and safeguarding them from misappropriation:

1. The person who approves purchases should not prepare the checks for payment.
2. The person who prepares the checks should not be authorized to sign them.
3. The check signer should not be the person who approves invoices for payment.

In many small churches, the same individual may perform all three of the above procedures. That's not an ideal situation and one that could lead to a problem somewhere down the line. At the very least, a church should appoint different individuals to count weekly offerings as to pay the bills. But segregating the duties of purchase approval, check preparation, and check signing is the best way to control the disbursement of funds.

Safeguards

Two signatures. More than one signature should be required on checks over a certain amount. The dollar amount could vary, depending on the size of the church one signature is generally adequate on checks of a modest amount.

The level of a church's controls on expenditures should help you determine when more than one signature is necessary. For example, if a large church has a business administrator who approves purchases, and all check requests require the approval of the church treasurer before checks are written, then one signature may be sufficient for most checks. However, if a church has no budget and no written procedures for disbursing funds, requiring two signatures on all checks should help offset the missing controls.

Limited signers. Access to a church checking account should be limited to a few individuals. Having more than one signer is very helpful when the treasurer is on vacation or unavailable. But church pastors should not be authorized to sign checks. That would be a serious breach of good internal control.

No blank checks. Checks should never be signed in advance of filling in the amount of the check. Use petty cash for minor cash expenditures. Larger expenditures that might require an immediate disbursement are better handled by establishing open accounts with vendors or charging items on a church credit card. Otherwise, expenditure should wait until an exact amount can be determined and documented.

More than one account. One bank account is sufficient for a church if its accounting system breaks down various types of funds (for example, operating, building, and scholarship). However, if the church has trust or endowment funds, those funds should be handled through a separate bank account.

Spending Policies

Your church could adopt a number of policies on how it spends money. Some of those policies:

- Limited terms for treasurers. Consider limiting the term of your treasurer to a defined timeframe. This will give the person who does the job a needed break plus it will provide the opportunity for other qualified people to serve. It also protects the church from making traditional some practices that may not be in the church's best interest.

- Annual review of check signers. Once a year, the church board should adopt a resolution authorizing check signers. Otherwise, there may be individuals authorized on the bank signature cards who are no longer church officers.

How to Pay Bills

An important element of proper stewardship is to develop, implement and live by a *well-defined, written bill approval and payment process*. Some key ingredients of such a plan:

A clear description of who will:

- Approve bills
- Receive goods
- Validate invoice with purchase order and receiving documents
- Prepare checks for payment
- Sign checks
- Mail bills
- Record transactions in the general ledger

Most bills for a church can be paid once a month. Payments should be based on original invoices and supporting documentation. If payment is based on copies of original documentation, it can be easy to pay the same item twice. Invoices should be checked for accuracy before being paid.

Payments should not be made from month-end statements. Typically, such statements do not include the details of products or services provided and are not an adequate basis for payment.

When each check is written, the supporting document should be marked with “paid” as well as the date and date number if someone other than the treasurer prepares the checks, the treasurer should review supporting documents before signing the checks. The supporting material should then be filed in a paid-bills file alphabetized according to payee. Checks should never be written payable to cash because it is essential to know what funds are used for. It is acceptable to issue checks to petty cash, however, when replenishing that fund.

How to Approve Expenditures

The approval process for expenditures depends on the policies of a church. In a small church, the treasurer may be authorized to approve expenses if funds are available in an approved budget. In a larger church, an elaborate system of expense approvals may be necessary to manage disbursements.

Although every church should have a budget, many do not. In the absence of a budget, the treasurer must use his/her judgment about the appropriateness of an expense as well as whether funds are available to pay for it. This puts undue pressure upon a treasurer and could be a setup for mismanagement.

Many expenses relate to departments of the church such as Sunday school, children, young people, seniors, and maintenance. It's a good idea to require the approval of a departmental representative before an expense is paid.

Documentation of Expenses

Every check should have some sort of written document to support it- an invoice, petty-cash voucher, travel-expense report, payroll time sheet.

In other cases, there may be good reason why written documentation is not available. The treasurer should determine when the lack of documentation is acceptable. For example, an honorarium may be requested for a visiting speaker. A written check request indicating the date of the speaking engagement and the event would normally be sufficient.

Or, a pastor may have lost an invoice for a ministry expense he or she paid out of pocket. If the amount paid is within reason, a written explanation of the item and why documentation is missing should be adequate. Good management of a church's funds requires an effective system of disbursing funds.

Some of the effects of a proper system include adequate internal controls over all expenditures, proper disbursements of funds, and efficient reporting of the use of funds.

5. The Finance Committee

The finance committee is the administrative board's primary direct representation covering all things related to the finances of the church. The finance committee's antifraud role is one of both oversight and participation. The finance committee should constantly challenge procedures to enforce the antifraud policies of the church. It should regularly evaluate the church's identification of fraud risks and their responses to those risks, including the adequacy of the organization's internal financial controls. It should support and assess the church's creation of a culture with a "zero tolerance" for fraud. The finance

committee should also assess the risk of fraud by developing appropriate responses to those risks.

Among other things, the finance committee should:

- Remain alert to factors that might indicate management fraud, including changes in life-style
- Consider periodically reviewing management travel and other expenses
- Carefully review unusual and complex financial transactions
- Consider periodically reviewing significant nonstandard journal entries, especially those near year-end
- Monitor compliance with the organization's general code of conduct and conflict-of-interest policies
- Identify and assess the propriety of related party relationships and transactions at all levels
- Monitor the adequacy of the organization's information management system and other physical security measures required to protect the entity from fraud and abuse
- Ensure that every employee or volunteer is aware that the committee is the contact point for reporting suspected fraud or abuse and that the "whistleblower" will be protected
- Take the lead in investigating suspected fraud and abuse, including communicating appropriate matters to legal counsel and government authorities
- Review the adequacy of insurance coverage associated with fraud and abuse
- Communicate with external auditors regarding the audit committee's assessment of fraud risks, the entity's responses to those risks and any suspected or actual fraud and abuse reported to it during the year
- Oversee the internal audit function or perform certain internal audit functions if needed
- Conduct background checks to include criminal and credit reviews on all employees

In fulfilling its responsibilities, the finance committee should carefully document its actions and periodically report to the administrative board.

6. Asset Misappropriations

The following examples provide areas of weakness commonly found in organizations. This is not an all encompassing list but should provide a starting point for your review.

Revenue and Cash Receipts Schemes

- **Skimming**- theft of cash before the funds have been recorded on the books. Skimming can be perpetrated by someone who either initially collects or opens incoming mail, the person who initially logs in cash receipts, prepares the deposit or takes the deposit to the bank, or door-to-door solicitors of charitable contributions. Checks can also be skimmed. The perpetrator opens up a bank account in the organization's name with themselves as a signer and simply deposits and withdraws the checks.
- **Theft of Donated Merchandise**- donated merchandise can be just as susceptible to theft as cash. While it may be a little harder for the perpetrator to carry the merchandise out, most organizations have poor controls or recordkeeping over donated items.

Purchasing and Cash Disbursement Schemes

- **Credit Card Abuse**- perpetrators either use organization issued cards for personal use, or more damaging for the organization is the use of credit card numbers of donors.
- **Fictitious Vendor Schemes**- perpetrators set up a company and submit fake invoices to the organization for payment.

Payroll and Employee Expense Reporting Schemes

- **Ghost Employees**- whereby either terminated employees are left on the payroll system, or fake employees are set up in payroll. Payroll checks are issued for nonexistent employees and the checks are cashed by the perpetrator.
- **Overstatement of Hours Worked**- A recent survey found that 16 percent of the 617 workers surveyed reported witnessing the claiming of extra hours worked by other employees.
- **Fictitious Expenditures**- submission of fictitious expenditures for reimbursement has become a significant problem especially with the evolution of desktop publishing. The effort involved in creating a bogus invoice for reimbursement can be rather minimal.

7. When Fraud is Discovered

Fraud can be suspected or discovered by many sources, such as employees, internal auditors, vendors, and others. If fraud is discovered or there is a reasonable basis to believe that improprieties have occurred, the audit committee should be notified

immediately and is responsible for ensuring that an investigation is conducted. If necessary, external auditors, internal auditors, or certified fraud examiners may need to be engaged to assist the audit committee with the investigation. The audit committee should also consider the following actions, among others:

- Immediately inform the District Superintendent and the Conference
- Consult legal counsel on the prudent steps to take in order to protect the rights of the accused and ensure the rights of the organization
- Inform the organization's insurance carrier of the suspected or discovered fraud loss in accordance with the terms of the insurance policy
- Preserve the documents or other evidence that may be needed in proving the fraud
- Repair the breach in internal controls, policies and procedures that made the fraud possible
- In certain cases, inform law enforcement or appropriate government authorities
- It is important to use discretion and confidentiality when dealing with an issue

8. Conclusion

It is important that we remain good stewards of the funds entrusted to us. The above recommendations, while not all encompassing, should provide you with an avenue to ensure that your controls and procedures are in place to avoid any irregularities or issues that may arise. It is important to remember that good policies begin with the leadership of an organization and it is vital to put controls in place to ensure that the assets of the church are secure.

"Be shepherds of God's flock that is under your care, serving as overseers-not because you must, but because you are willing, as God wants you to be; not greedy for money, but eager to serve" 1 Peter 5:2