

A Financial Examination Guide

For Baptist
Churches and Associations



Compiled by
Marvin Peters, D. Min.

© Arkansas Baptist State Convention, Little Rock, Arkansas, 2004

All rights reserved. This publication may be reproduced by Arkansas Baptist Associations for use as needed. Reproductions by other organizations and groups are restricted without prior written permission by the publisher. All inquiries should be addressed to: Mission Ministries Team, Associational Missions Development, Arkansas Baptist State Convention, P. O. Box 552, Little Rock, Arkansas, 72203; or call (501) 376-4791 or (800) 838-2272, Ext. 5150; fax (501) 375-7463.

Disclaimer

The Arkansas Baptist State Convention is not responsible for conducting financial examinations or audit/reviews for churches and associations, nor does the Arkansas Baptist State Convention provide legal or financial advice through this booklet. Local churches and associations should seek assistance and advice from local financial advisors when specific issues arise.

This booklet is provided as a service. It is designed to be used to increase the knowledge of generally accepted accounting principles, including the understanding of why a financial examination or audit/review should be conducted and the uses to which they can be applied in churches and associations.

Acknowledgements

Gratitude is expressed to Dan Jordan, Team Leader, Business Affairs Team, and Jeff Corley, Comptroller of the Arkansas Baptist State Convention for their input and guidance in putting this guide together.

John and Scott Chism of the John Chism Accounting Firm checked this booklet for accuracy and that the guidelines were in accordance with generally accepted accounting procedures.

Contents

1	Introduction Page 7
----------	--------------------------------------

2	Definition of Terms Page 11
----------	--

3	Conducting the Examination. . . . Page 13
----------	--

4	The Report Page 25
----------	-------------------------------------

5	Appendices Page 33
----------	-------------------------------------

6	Sources. Page 41
----------	---------------------------------

Introduction

A commonly asked question is, “Why do we need to conduct a financial examination or an audit/review?” Actually, there is not one answer to fit all situations, but here are a few good reasons.

1. This is the best way to:
 - Protect the persons who are elected to positions of financial responsibility from unwarranted charges and careless or improper handling of funds.
 - Build the trust and confidence of the financial supporters of churches and associations in the way the money they contribute is being properly accounted for (trust and confidence lead to improved patterns of financial support).
 - 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.
 - Assure that financial gifts made to the church or association with special conditions attached are consistently administered in accordance with the donors’ desires, and thus lets donors know that their gifts are used as intended.
 - Provide checks and balances for monies received and expended.
2. Conducting a financial examination or an audit/review is *not* a symbol of distrust.
3. Conducting a financial examination or an audit/review is a characteristic of responsibility.
4. Conducting a financial examination or an audit/review is good stewardship.
5. Conducting a financial examination is a message to those who make contributions that the church or association cares about their financial support.

Different types of financial examinations or audit/reviews are available to churches and associations. The most formal and structured type is an independent audit/review performed by a Certified Public Accountant (CPA) or a Public Account (PA). These audit/reviews are conducted according to uniform national standards and result in an objective opinion on the fairness of the association’s financial statements. This type of audit review can be costly. Church and associational leaders may want to consult with local CPAs or PAs about the possibility of pro bono work. Often there are CPAs or PAs who are church members who will consider conducting an audit/review for no cost or at discounted fees.

An audit/review conducted by a Certified Public Accountant or Public Accountant is a wise choice. Churches and associations with annual receipts in excess of \$200,000 should seriously consider the services of a professional auditor.

It is clearly recognized that not all churches and associations can afford the service of a professional auditor. If this is the case, then the church or association has the option to conduct an annual internal financial examination. The internal financial examination is the subject of this booklet.

A question to be considered:

What kind of financial examination is specified in the church or association's guiding documents? The guiding documents may require that an annual audit/review be conducted by a certified public accountant. Or, the guiding documents may not specify any type of financial examination, or even that one is conducted. If this is the case, the church or association is free to conduct an internal financial examination.

1. A Financial Examination Committee

A Financial Examination Committee should be selected before beginning a financial examination. If the guiding documents do not give guidance in the selection of Financial Examination Committee, one can be appointed at the instruction of the church or association in business session, or selected by the team or committee that is responsible for the selection of officers and committees, and elected in a business session.

The qualifications of Financial Examination Committee members include:

- **They should be active members of the church or associational churches.** They should be elected by the church or association in a business session.
- **Those selected to conduct the financial examination should have some reasonable knowledge of the terms, concepts and practices of financial matters.** It is unreasonable to assume that anyone who is not familiar with financial matters can publicly express an opinion on the accuracy of something they do not understand.
- **The single most important characteristic the Financial Examination Committee members need to possess is integrity.** In order for the financial examination to be useful and effective, the person or persons performing it must do so in an objective and impartial fashion, with the highest degree of integrity. The committee lends public credibility to the financial reports of the church or association. If the members of the Financial Examination Committee are biased or lacking in financial knowledge or ability, then credibility is compromised.
- **Persons who are responsible for the church or association's finances should not serve on the Financial Examination Committee.** This includes the treasurer, financial secretary, pastor or associational missionary, and their spouses, relatives and close friends. To do so infringes upon the integrity of the examination.
- **The Financial Examination Committee must not function as a rubber stamp of approval for whatever is presented to them.** To be truly effective, the Financial

Examination Committee must be given the time, resources, and access that are needed. Only then will their report have meaning.

2. The purpose of this booklet.

The purpose of this booklet is to help the Financial Examination Committee focus its attention on the critical areas and to give them a reasonably simple set of procedures to follow that will allow them to carry out their task and feel they have done so effectively.



Definition of Terms

The use of the term *financial examination* in this booklet is meant to be a process that provides reasonable assurance that good stewardship is being used in handling and accounting for the funds and other assets of the church or association. To a professional auditor or accountant, our definition of a financial examination will be closer to what they would call a “review.”

Our practical working definition of a financial examination is:

An evaluation of the financial reports and records and the internal controls of a church or association by a qualified person or persons for the purpose of reasonably verifying the reliability of financial reporting, determining that the assets are being safeguarded, and that the financial policies and procedures are being complied with.

I. Types of Funds

Churches and associations receive funds and assets for its operation in three different ways. There are the assets for the general fund, designated funds, and restricted funds.

1. General Funds

The general fund assets are the cash receipts given for the general operation of the church or association. These assets are received with no specific designation or stipulation other than use for the daily operation. The operating budget receives most of its funding from these general funds.

2. Designated Funds

Designated funds have been set-aside for a specific purpose by vote of the church or association. For example, a church or the association in business session votes to set aside \$5,000 from its funds to provide scholarships to ten people to go on a mission trip next year. This money would be reported on the financial statement as a “designated” account. Because the stipulation for its particular use was made by vote in a business session, that stipulation can be changed only by a vote of the church or association in session. If, for some reason, the money was not used as intended, the church or association in session can vote to designate the money, or use the money for some other worthy purpose.

3. Restricted Funds¹

Restricted funds are those assets that have been given by churches, individuals, the Arkansas Baptist State Convention, or other donors with a stipulation imposed upon its use. Restricted funds fall into two categories: temporarily restricted funds and permanently restricted funds.

- **Temporarily Restricted Funds.**

Temporarily restricted funds are assets given for a specific purpose, such as Hunger Funds, special mission projects, Lottie Moon Missions Offering, mission trips, building fund, etc. In most cases, these funds are called designated funds. Once the gift has been accepted, it is to be used only for the specified purpose, and must be accounted for separately from the gifts given for general funds. If these restricted gifts are used for any purpose other than specified, the donor (or an heir of a deceased donor) may be entitled by law to ask for the return of the gift, even years later. For example, if a gift of \$10,000 is given for the purchase of property, that money must be spent only for that purpose, and reported in the financial records for that specific purpose. If the same \$10,000 was given with the stipulation that it is to be invested and the original gift plus the income off of the investment is to be used to purchase property for a new church, then the entire \$10,000 with its income is to be used only to purchase property for a new church. The difference is that in the first case, only the \$10,000 is restricted to the purchase of property for a new church, whereas in the second example, the \$10,000 with all of its investment income is to be used in the purchase of the property.

The church or association cannot change any restriction of funds without the specific consent of the donor. This consent should be written.

- **Permanently Restricted Funds.**

Permanently restricted funds are assets given in the form of bequests or endowments. These funds usually specify that the initial gift be invested and the interest from the investment be used for a specific purpose. These funds should be reported on the church or association's financial statement and show the interest income and how the interest income has been used. These funds are part of the annual financial examination.

¹ In many churches and associations, restricted funds are called "designated funds." By what ever name, they are still restricted by the same guidelines as described here.



Conducting the Financial Examination

Many churches and associations do not operate by the generally accepted accounting principles. It is a good idea to do so, especially if there should need to publish the financial statements to an outside party. For example, if the church or association decides to build and needs to secure a loan to do so, then the lending institution will require that the financial statements be audited or reviewed by an independent auditing firm or that the financial statements comply with generally accepted accounting principles.

The objectives of a church or an association conducting a financial examination may be somewhat narrower than those of a CPA auditing the financial statements of a business. However, there are some similarities. Businesses are required to present their financial statements to its shareholders or to the public. In comparison, churches and associations must report their financial statements to their shareholders, i.e., their members. For that reason, it is important that the financial statements be accurate.

I. The Focus of a Financial Examination.

The focus of a financial examination centers on the information that revolves around cash receipts and cash payments.

- The objective is to satisfy the members that all cash received has been recorded properly and deposited into a bank account with limited access, and that all cash payments have been authorized and are properly documented, recorded and used for conducting business as approved by the church or association.
- The financial examination will satisfy the members that all receipts and payments are correctly classified and reported in the annual financial reports, the information contained in them agrees with the underlying records, and that the budget has been properly adhered to.
- It will examine the investments (savings, investments in the Baptist Foundation, certificates of deposits (CDs), etc.) to determine if the investments are recorded properly, and will assure that required payments on any outstanding loans or mortgages have been made during the year, and that the balances reported in the financial reports are accurate.

- The financial examination will reveal that the payroll is handled as intended and that the staff is being paid at the approved rate.
- It will satisfy the church or association that it has adequate insurance coverage for all property and potential liabilities.
- It will assure that the property and office equipment are present and accounted for, and being used properly.
- It will ensure that the financial reports and monthly accounting principles are in agreement with the financial policies and procedures. The financial examination can reveal a need to review and revise the financial policies and procedures.

The Financial Examination Committee should document the work as it is done. There should be a final report made to the church membership or associational leadership as to the soundness of the financial reports and financial policies and procedures.

II. Getting Ready to Conduct the Financial Examination.

Before the financial examination begins there are some things that the Financial Examination Committee must do before conducting the examination.

- The Financial Examination Committee must understand the church or association's accounting system that generates the financial statements and internal examination controls.
- The minutes of the church's business meetings or association's annual meeting and executive board meetings of the previous year should be collected to check for the authorization of the budget and expenditures of the year being examined.
- A copy of the previous financial examination (if any) should be obtained in order to verify the beginning balances of the assets. An auditor's or Financial Examination Committee's report of the previous year will provide information of past findings and suggestions on how to improve the church or association's financial operations.
- A copy of the financial statements as prepared and presented by the treasurer or financial secretary should be obtained.
- The process being used to account for the church or association's monies should be reviewed. The persons with responsibility for the financial operations should be identified. They should be asked to confirm that all funds are included in the financial statements.
- All bank accounts and authorized check and withdrawal signers for those accounts should be identified.
- All accounting records of all funds should be presented together. These include:
 - Chart of accounts and organizational chart.
 - General ledger (or computer printout).
 - Cash receipt journals (or computer printout).
 - Cash disbursements journals (or computer printout).

- Bank statements, including canceled and voided checks.
 - Blank checks, both in and out of the binder.
 - Paid invoices.
 - Individual payroll records, including forms W-2, W-4, and I-9.
 - Federal and state payroll withholding reports.
 - Passbooks and evidence of other investments (Baptist Foundation, CDs, savings, etc).
 - Bank deposit receipts.
- A preliminary analytical review of the financial statements should be completed. This may consist of a comparison of the current accounts to the previous year balance and the budgeted amounts. Investigate any significant differences from the previous year to the current year. Interview the treasurer or financial secretary, asking about any financial matters noted in the minutes. Investigate any matters that occurred during the year in which the committee needs to be aware of before beginning the financial examination.

III. Conducting the Financial Examination.

A. Cash Receipts and Cash Balances

The largest focus of the financial examination will be centered on the information that revolves around cash receipts and cash balances.

1. Transactions

- **Choose a Random Sample.**

Much of the financial examination will revolve around the cash transactions of the church or association. Those conducting the examination may not be able to check every event and transaction that occurred during the year. An alternative is to choose a sample and draw conclusions from the examination of this sample. The size and extent of the sample is a matter of judgment and will depend on the time and resources that those who conduct the financial examination will have available. Regardless of how large or small a sample is chosen, the sample should be representative of the whole year's activity as possible.

- **Examine the Financial Documents.**

Once the sample is chosen, the Financial Examination Committee should examine the document produced by the person or persons who received the funds, recorded them, and made the deposits. The total should be verified by addition, then traced to both a deposit slip and the next subsequent bank statement to establish that all cash received

was deposited into the proper bank account. Additionally, the total collected should be traced to an entry in the accounting records.

- **Clear up any Discrepancies.**

If any discrepancies are found, the Financial Examination Committee should request an explanation from the person who was responsible for the transaction in question. The committee must exercise judgment in assessing the validity of the explanation given. If satisfied, they may consider the matter closed. If they are not satisfied, they may choose to consult with the church or associational leadership or officers before proceeding. Before taking this step, the Financial Examination Committee should be certain that they have fully investigated the transactions in question and documented its work so that a full description may be presented to the associational leadership and officers.

- **Verify total receipts.**

The Financial Examination Committee will want to verify the total receipts for the year. Listing and adding the totals of the monthly offerings to produce a yearly total can do this. The committee will want to obtain a sample confirmation of contribution records by sending a letter to selected individuals (or churches for the association) to confirm that their record of contribution agrees with the church or association's records. Once established, the annual totals should also be compared to budgeted amounts for the year and to similar amounts for prior years. An explanation should be secured for any significant unexpected variations.

- **The Goal.**

The Financial Examination Committee will not be able to achieve 100% certainty regarding the correctness of the annual totals of receipts and disbursements in the financial reports. Every transaction that occurred during the year cannot possibly be examined, and there is the possibility of human error on their part. ***The goal is to reach a level of reasonable certainty that there are no significant errors contained in the totals.***

2. Year End Balances

The Financial Examination Committee should begin the procedure of checking the year-end balances by identifying all the separate individual bank accounts and listing them with account numbers, and indicating whether they are checking or savings accounts. This list should be maintained by the committee and compared to the previous year's list with any changes being noted. Any change in the list of bank accounts should be traceable to the minutes where such an account opening or closing should have been authorized.

- **Examine Passbooks and Bank Statements.**

Savings account passbooks or statements should be examined and the balance determined as of the date of the fiscal year-end. This balance should agree with the balance shown in the year-end financial report. The minutes should be examined for any indication of new accounts opened during the year, and any accounts should be traced both to the list of accounts and the year-end financial reports.

- **Examine Bank Reconciliations.**

The treasurer or financial secretary should reconcile all checking accounts monthly. The Financial Examination Committee will want to examine at least the reconciliation coinciding with the year-end report. Items listed on the reconciliation and used to bring the bank balance to agreement with the checkbook are called reconciling items. Routine reconciling items such as deposits made at the end of the month and not yet credited on the statement (deposits in transit) or checks written and recorded but not yet charged by the bank (outstanding checks) should be verified as legitimate by tracing them to the next subsequent bank statement. Any significant delay in a deposit appearing on the bank statement should be investigated. The committee must note the possibility that cash (checks) received on the last days of the month may be held in the safe for a short period before being deposited. This cash might be listed as a “deposit in transit” even though it might not have been deposited prior to the end of the month. This is not ideal, but it provides an explanation for a short delay in the deposit reaching the bank.

- **Investigate Outstanding Checks.**

Checks listed as outstanding on the reconciliation should normally clear the bank and be listed on the bank statement during the subsequent month. Any outstanding checks that do not clear the bank during the subsequent month should be investigated.

- **Investigate Non-Routine and Unusual Items.**

Any reconciling items that appear to be non-routine or unusual should also be investigated, seeking an explanation and documentation to verify the legitimacy of the items. It is most important that the Financial Examination Committee is satisfied that the bank’s records are in agreement with the records of the church or association. Reconciling items that appear month after month on the reconciliation are always suspect and should be investigated and resolved. Any reconciling item that appears continually is likely an indication of an uncorrected error, which must be investigated and resolved.

3. Petty Cash

If there is a petty cash fund, the Financial Examination Committee should determine the basis on which it is operated. Normally, an amount is set as to the size of the fund. That amount of cash is withdrawn from the bank to start the fund, and any expenditure is documented with a petty cash voucher that is placed in the fund box or drawer. There should also be a set limit on the size of individual expenditures; any large expenditure would require normal cash payment (check) processing. No additional cash is added to the fund until it is nearly exhausted. At that point, all vouchers are summarized and recorded in appropriate expense categories, and a corresponding amount is withdrawn (upon approval) and placed in the fund. This returns the fund to its initial size. Should a shortage or overage occur, they should be treated as miscellaneous expense (shortage) or miscellaneous income (overage). At any time, the fund should contain a combination of cash and vouchers equal to the preset size and allows for easy verification counts of the fund at any time. If the petty cash fund is not kept on this basis, the Financial Examination Committee should recommend that this method be adopted.

4. Other accounts.

Many churches and associations have funds invested with the Arkansas Baptist Foundation and/or in Certificates of Deposit (CDs). These accounts should be examined in the same manner as the savings account. An end of the year statement should be obtained, and the amount compared with the financial report. Any opening of new accounts and closing accounts, and withdrawals should be checked against the minutes for approval.

Check List for Receipts and Balances

1. Obtain a list of monthly contributions.
2. Trace these contributions to the accounting records and note any discrepancies.
3. Compare the contribution record to the deposit slips.
4. Trace the deposit slips to the next subsequent bank statement. Note any discrepancy.
5. Obtain a list of all bank accounts (checking and savings) owned. Trace any opening and closing to the minutes.
6. Obtain the year-end statement for all savings accounts and determine the fiscal year end balance. Compare this balance to the balance listed in the annual financial report. Investigate any differences.
7. For each checking account, obtain the year-end bank reconciliation and the bank statements for the last month of the fiscal year and the first month of the new fiscal year. Trace the bank balance from the reconciliation to the bank statement.
8. Trace any normal reconciling items such as deposits in transition or outstanding checks to the next bank statement, looking for any undue delays in clearing.
9. Investigate any unusual or non-recurring items, obtaining documentation of legitimacy. If such items exist, examine prior months reconciliation's to see if the items have been carried forward from month to month.
10. Once reconciling items are verified, compare the "book balance" from the reconciliation to the balance in the accounting records as of the fiscal year-end to the balance reported in the annual financial reports.
11. Count the petty cash fund and determine that the fund is intact.
12. Choose one prior reimbursement of the petty cash fund and examine the documentation in order to establish the validity of items and amounts expended from the fund.

B. Cash Payments

The Financial Examination Committee will want to be satisfied that all recorded expenditures are legitimate and accurate and that they were properly authorized. As previously mentioned, it may be impossible to examine all individual expenditures, so a plan for using a sample should be decided upon.

1. Beginning the Examination of Individual Transactions.

Before beginning the examination of individual transactions, the Financial Examination Committee should obtain a list of all banks accounts from which payments were made. For each one, it should also obtain a list of those persons who are authorized to sign checks or make withdrawals. These lists should be compared to the prior year's list and verified with the guiding documents. The committee should also determine the approval process that is being used and satisfy themselves that all expenditures are subjected to an adequate review and approval before payment. This process will vary from place to place, and in some cases will require that almost all expenditures be approved, except recurring ones. In other cases, approval may be given for all budgeted items, with special approval needed only for non-budgeted items.

2. Obtain a Listing of all Disbursements.

In order to begin the testing, the Financial Examination Committee should obtain the listing of all disbursements for the year. This may take the form of a journal, spreadsheet, a series of cash summaries, or simply a checkbook register. Whatever form, the committee must establish a sample of individual items to choose from. For each sample, the examination committee must establish that the item is a legitimate obligation, that its payment was approved, that it was recorded and charged to the appropriate account, and that it has been included in the correct category in the annual financial report.

Check List for Cash Payments

1. Obtain a list of all bank accounts used to make payments and a list of persons authorized to sign checks or make withdrawals for each account. Compare the list to that from prior years and verify the authorized check signers with the minutes.
2. Obtain the cash disbursements journal or other listing of all disbursements for the year and choose a sample of disbursements for examination.
3. For each item chosen, obtain all supporting documentation and the canceled check.
4. Examine the supporting documents for evidence that the item is a legitimate obligation, and for evidence of approval for payment.
5. Examine the canceled check noting the authorized signature and the payee, and determine that the endorsement is consistent with the payee.
6. Determine the appropriate account to be charged for each item and trace each item to an entry in the accounting records to determine that the correct account was charged.
7. Scan the numerical sequence of checks issued during the year and investigate any missing numbers.
8. Examine all checks listed as "Void" in the checkbook or disbursements journal.

3. Obtain Supporting Documents.

To accomplish its goals, the Financial Examination Committee will want to obtain and examine the supporting documents and the canceled check for all expenditures chosen in the sample. **Note: Many banks are not sending copies of checks with the bank statements. This step may need to be omitted if this is the case for your bank.** The invoice and other documents should provide evidence that the item is a legitimate purchase and not a personal item, as well as verifying the amount of the expenditure. The invoice should bear evidence of approval for payment, either by stamp, signature, or initials. The check should be made out to the appropriate vendor indicated on the invoice, should be signed by one of the approved check signers, and the endorsement on the check should be consistent with the payee indicated by the invoice. This process will allow the committee to establish the legitimacy of the expenditures chosen in the sample.

4. Determine Appropriate Account Categories.

The Financial Examination Committee must also determine the appropriate account category of each of its sample expenditures and determine that the item was charged to that appropriate account. This is necessary to establish the accuracy of the reported information in the annual financial report. Therefore each item chosen should be traced to an entry in the accounting records as a cash payment and as a charge to the appropriate account category.

5. Scan the Numerical Sequence of the Checks.

The Financial Examination Committee should scan the numerical sequence of checks recorded and investigate any missing numbers. There may be voided checks, and if so, the voided checks should be obtained and examined. Voided checks should not be destroyed, but marked "Void" and retained. Unexplained gaps in the recorded sequence of checks or "voided" checks that cannot be produced for examination could be evidence of unrecorded, and possibly, non-approved disbursements of funds.

C. Payroll

Examining the payroll will differ in significance from one place to another. In some churches and associations, the pastor or associational missionary is the only paid staff person, while in other places, there may be a secretary, either full or part time, and other staff persons, either full or part time. Since most churches and associations do their own payroll as opposed to using a payroll service, the Financial Examination Committee will want to test some transactions in this area.

1. Payroll Payments and Deductions.

The objectives of examining the payroll will overlap those in the cash payments area. The Financial Examination Committee must attempt to satisfy themselves that all payroll

payments are to actual employees and that the rate of pay is according to that which has been approved. Additionally, it should be determined that all required deductions for payroll taxes are being made and that any other deductions have been properly authorized by the employee. These may include salary reductions for 403(b) retirement plans, health insurance plans, cafeteria plans, etc. The employee should authorize all voluntary deductions in writing.

2. Payroll taxes.

If payroll taxes or other items are being withheld, the Financial Examination Committee must be satisfied that amounts withheld are being remitted to the proper government or other organization on a timely basis.

Federal payroll taxes withheld require the filing of a quarterly form 941 to report and pay any federal income and FICA (Social Security and Medicare) taxes withheld. Arkansas law requires that a monthly or an annual form for State income tax withholdings to be filed. The Financial Examination Committee will have to determine that these required forms are being filed as required.

Note: Compensation for ministers is a complex and delicate area. This brief discussion is not intended to be a thorough discussion of the subject. In general, pastors and associational missionaries are considered as employees for income tax purposes but as self-employed for Social Security tax purposes. This is in accordance with current IRS regulations. The church or association does not withhold Social Security taxes, but can withhold Federal and State Income taxes. The pastor or associational missionary may ask that an additional amount be withheld to cover Self-Employment taxes, but is sent in as Federal Income Tax or given directly to the minister. He must agree in writing on the amount to be withdrawn by filling out a W-4 form. The church or association must issue a W-2 form to the pastor or associational missionary at the end of the year indicating salary and any taxes that have been withheld. Housing allowances must be declared and approved prospectively to the year claimed by both the pastor or associational missionary and the church or association, and should be recorded in the minutes of the business session in which it was approved.²

Check List for Payroll Taxes

1. Compare actual rates of pay with authorized rates in the minutes.
2. Examine withholdings and deductions from paycheck of chosen individuals and examine documents authorizing any volunteer deductions.
3. Examine quarterly payroll tax returns and compare amounts reported thereon for one or more employees to the amounts reported on the employee's W-2 forms. Investigate any discrepancies.

All other employees (non-ministerial, such as the secretary, camp manager, etc.) are subject to both Federal and State income taxes and FICA taxes being withheld and therefore must receive W-2 forms at the end of the year. All persons not employed, but

² Contact your State Convention's Stewardship and Annuity representative or Guidestone Financial Services for a copy of "Planning Financial Support for Ministers and Church Employees."

paid \$600 or more during the year for services must receive a form 1099 Miscellaneous stating the amount they received.

D. Property, Insurance and Miscellaneous Items

The largest and most valuable property that a church or association owns is buildings. Some associations own camps, and a few churches and associations own a house in which the pastor or associational missionary and his family live in as part of his compensation.

Additionally, there will be numerous pieces of property that are essential to the operation of the church or association. These will include office equipment (desks, chairs, computers, copiers, etc.), audio visual and video equipment, tables, chairs, etc.

1. Objectives

The objectives of the examination of property and insurance are to:

- Satisfy the church or association that the property belonging to it has been catalogued and listed, and that all listed property is present and being properly used.
- Assure the members that any changes of the listed property from the previous year to the current year (purchases and dispositions) have been properly authorized.
- Confirm that the any property owned, especially real property, is adequately insured and the coverage is up to date.

In compiling the list of property, the leadership may set minimum value of the items to be listed in order to avoid having to list inconsequential items such as coffee mugs, pencils, etc. The minimum value might be \$100 or less.

2. Property

Practice differs from one place to another as to whether real and personal property is presented in the annual financial report. Among those that list the property in their annual report, there is deviation in listing the depreciation on the property. Therefore, the Financial Examination Committee must tailor its approach to the individual needs of its client. However, they should be governed by the financial examination's objectives of existence, ownership, and completeness. The questions that

Check List for Property, Insurance and Miscellaneous Items

1. Obtain a master list of all real and personal property and compare it to last year. Determine that any additions or disposals were properly authorized.
2. For any new items on the list, examine the items to determine that they are present. Spot check older items to be certain they are present.
3. Examine current insurance policies for dates and amounts to determine that adequate coverage exists.
4. Obtain year-end statements for any mortgages or loans and determine the correct year-end balance. Trace this amount to annual financial report.
5. Determine that mortgages and loan payments are up to date.
6. Check that any safe deposit boxes are being maintained and that any contents of the box can be verified by the committee. Check that only authorized persons can gain entry.

the committee must ask are, “Does all reported or listed property belong to the church or association?” “Does all of the listed property exist within the church or association?” “Does any such listing or reporting include all property belonging to the church or association?”

3. Mortgages

With the ownership of real property there is often the financial responsibility of a mortgage or other debt. The property is usually pledged as collateral for the loan. Such debt should be reported in the financial reports so that all leadership and members are aware of the financial obligations imposed by the debt. Successfully meeting monthly mortgage and loan payments requires planning which can only be accomplished if the leadership is aware of the financial obligation. The Financial Examination Committee should seek to make certain that all such debt is fully communicated in the financial reports. The committee should determine that all mortgage and loan payments are up to date, and if not, should communicate this fact to the leadership.

4. Insurance coverage

An essential part of the examination of property is to assure that all property owned is adequately insured; both in replacement value and liability coverage, and that the coverage is up to date.

5. Safe Deposit Box.

If there is a safe deposit box, the Financial Examination Committee should check that it is being maintained, and that all contents of the safe deposit box can be verified by the committee. A check should be made to assure that only authorized persons have entry into the box, and that signature cards are current.

E. Accounting Practices and Procedures

The Financial Examination Committee and church and associational leadership often overlook accounting procedures and practices. When accounting practices and procedures are ignored, problems in the accounting practices and procedures could produce problems and errors that might be impossible for the financial examiners to uncover.

An internal control system (accounting practices and procedures) serves to:

- **Safeguard the resources.**
- **Promote accuracy in the financial data produced.**
- **Promote operational efficiency.**

- Accounting practices and procedures are an internal control system. The Financial Examination Committee can assist the church or association by reviewing the practices and procedures and making constructive suggestions. This will likely have a dual benefit. Better accounting practices and procedures will better protect the

resources and also make the Financial Examination Committee's job easier in future years.

- An easy and effective way to evaluate the financial practices and procedures is by the use of a questionnaire. A suggested questionnaire is found in Appendix 5, page 38. The questionnaire is designed so that every question is answered with a yes, no or not applicable (NA). The questions are constructed in such a way that a yes answer reflects an acceptable practice; a no answer represents a potential weakness and is a basis for a constructive suggestion.



The Report

The work of the Financial Examination Committee will yield little or no benefit, unless the results of the financial examination are communicated to the church or associational leadership. This is accomplished by a report generated and signed by the members of the Financial Examination Committee. The report is attached to the annual financial report, which is submitted to the church or association and included in its annual report.

The language of the report will vary from place to place, but should include the following: 1) the subject of the report, namely the annual financial reports; 2) what the Financial Examination Committee did, namely examine the financial records and reports; 3) the limitations of the examination committee, namely that it is not a guarantee of accuracy; 4) an opinion on the fairness of the records and reports; and 5) a statement of financial position (balance sheet) and statement of activities sheets (income and expense statements) should be included with the report (sample forms included on pages 26-31). The committee may also wish to include a word of commendation for the work of the treasurer and financial secretary in its report.

With this work completed, the Financial Examination Committee should review its work with the pastor or associational missionary, the treasurer, and the financial secretary in order to answer any lingering questions, make any suggestions as to recommendations to changes or improvements in accounting procedures, and then consider preparation of the report.

**Statement of Financial Position
December 31, 2005**

Assets

Cash and Cash Equivalents	_____	
Land, Buildings and Equipment: Net	_____	
Total Assets	_____	_____

Liabilities and Net Assets

Liabilities

Payroll Withholdings	_____	
Other Liabilities	_____	
Total Liabilities		_____

Net Assets

Unrestricted Net Assets	_____	
Temporarily Restricted Net Assets	_____	
Permanently Restricted Net Assets	_____	
Total Net Assets		_____
Total Liabilities and Net Assets		_____

Statement of Activities
For the year ended December 31, 2005

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Support, Revenues, & Reclassifications				
General Offerings (Schedule 1)				
Other Non-Designated				
Interest Income				
Total Unrestricted Support and Revenues				
 Ark Baptist State Convention Support:				
 Total Ark Baptist State Convention Support				
Other Revenues and Support:				
 Total Other Revenues and Support				
Total Temporarily Restricted Support				
Total Permanently Restricted Support				
 <u>Net Assets Released from Restrictions</u>				
Satisfaction of Purpose Restrictions				
Total Support, Revenues, & Reclassifications				

Statement of Activities
For the year ended December 31, 2005

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Expenses				
<u>Overhead Expenses</u>	1			
Personnel				
Administration				
Buildings and Grounds				
Depreciation				
Other Non-Budget				
Total Overhead Expenses				
<u>Program Expenses</u>				
Total Program Expenses				
Total Expenses				
Less: Capitalized Items				
Total Expenses less Capitalized items				
Change in Net Assets				
Net Assets-Beginning of Year				
Net Assets-End of Year				

(Example)
Statement of Financial Position
December 31, 2004

Assets

Cash and Cash Equivalents	55,431.10	
Land, Buildings and Equipment: Net	<u>309,999.76</u>	
Total Assets	<u> </u>	<u><u>365,430.86</u></u>

Liabilities and Net Assets

Liabilities

Payroll Withholdings	<u>2,499.29</u>	
Total Liabilities		<u>2,499.29</u>

Net Assets

Unrestricted Net Assets	309,501.57	
Temporarily Restricted Net Assets	<u>53,430.00</u>	
Total Net Assets		<u>362,931.57</u>
Total Liabilities and Net Assets		<u><u>365,430.86</u></u>

Statement of Activities
For the year ended December 31, 2004

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Support, Revenues, & Reclassifications				
General Offerings (Schedule 1)	195,919.26			195,919.26
Mills Valley Fees	16,600.00			16,600.00
Other Non-Designated	4,920.00			4,920.00
Interest Income	<u>178.23</u>			<u>178.23</u>
Total Unrestricted Support and Revenues	<u>217,617.49</u>			<u>217,617.49</u>
Ark Baptist State Convention Support:				
African-American Ministries Coordinator		1,200.00		1,200.00
Caring Center Hunger Funds		3,600.00		3,600.00
Caring Center Salary Supplement		5,982.25		5,982.25
Christ Centered Fellowship		2,388.00		2,388.00
Hispanic Ministry		9,889.84		9,889.84
New Hope		1,000.00		1,000.00
School Supplies		<u>500.00</u>		<u>500.00</u>
Total Ark Baptist State Convention Support		<u>24,560.09</u>		<u>24,560.09</u>
Other Revenues and Support:				
Caring Centers-from Churches		6,554.04		6,554.04
Caring Centers-other than Churches		296.00		296.00
Christian Women's Job Corps		942.00		942.00
East Washington Building		1,800.00		1,800.00
Hispanic Ministry		26,844.85		26,844.85
Honduras		1,300.00		1,300.00
Interest Income		1,267.91		1,267.91
Mexico Mission Trip		28,865.56		28,865.56
New Hope		750.00		750.00
Van Receipts		5,037.34		5,037.34
TACMO		<u>300.00</u>		<u>300.00</u>
Total Other Revenues and Support		<u>73,957.70</u>		<u>73,957.70</u>
Total Temporarily Restricted Support		98,517.79		98,517.79
<u>Net Assets Released from Restrictions</u>				
Satisfaction of Purpose Restrictions	<u>88,729.57</u>	<u>(88,729.57)</u>		
Total Support, Revenues, & Reclassifications	<u>306,347.06</u>	<u>9,788.22</u>		<u>316,135.28</u>

Statement of Activities
For the year ended December 31, 2004

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Expenses				
<u>Overhead Expenses</u>				
Personnel	185,857.74			185,857.74
Administration	7,190.53			7,190.53
Buildings and Grounds	37,507.49			37,507.49
Depreciation	25,132.47			25,132.47
Other Non-Budget	<u>3,825.79</u>			<u>3,825.79</u>
Total Overhead Expenses	259,514.02			259,514.02
<u>Program Expenses</u>				
Program and Services	20,530.40			20,530.40
Caring Centers-from Donations	2,020.98			2,020.98
Caring Centers-from Hunger Funds	3,018.58			3,018.58
Christ Centered Fellowship	2,416.00			2,416.00
CWJC	1,208.60			1,208.60
DOM Search	484.55			484.55
East Washington Building	608.88			608.88
East Washington Ministry	3,412.48			3,412.48
Hispanic Work	4,220.88			4,220.88
Honduras Mission Project	1,600.00			1,600.00
Mexico Mission Trip	23,591.27			23,591.27
MFH Coord-ABSC	55.31			55.31
Miscellaneous	879.16			879.16
New Hope	1,000.00			1,000.00
New Ministry	100.00			100.00
Partnership Missions	313.51			313.51
School Supplies	777.84			777.84
TACMO	<u>203.67</u>			<u>203.67</u>
Total Program Expenses	<u>66,442.11</u>			<u>66,442.11</u>
Total Expenses	<u>325,956.13</u>			<u>325,956.13</u>
Less: Capitalized Items	<u>(6,895.12)</u>			<u>(6,895.12)</u>
Total Expenses less Capitalized items	<u>319,061.01</u>			<u>319,061.01</u>
Change in Net Assets	<u>(12,713.95)</u>	9,788.22		<u>(2,925.73)</u>
Net Assets-Beginning of Year	<u>322,215.52</u>	<u>43,641.78</u>		<u>365,857.30</u>
Net Assets-End of Year	<u>309,501.57</u>	<u>53,430.00</u>		<u>362,931.57</u>

Clarifications and Recommendations

1. Clarifications

2. Recommendations

Appendixes

Appendix 1

Checklist for Receipts and Balances

1. Obtain a list of monthly contributions.
2. Trace these contributions to the accounting records and note any discrepancies.
3. Compare the contribution record to the deposit slips.
4. Trace the deposit slips to the next subsequent bank statement. Note any discrepancy.
5. Obtain a list of all bank accounts (checking and savings) owned by the church or association. Trace any opening and closing to the minutes.
6. Obtain the year-end statement for all savings accounts and determine the fiscal year end balance. Compare this balance to the balance listed in the annual financial report. Investigate any differences.
7. For each checking account, obtain the year-end bank reconciliation and the bank statements for the last month of the fiscal year and the first month of the new fiscal year. Trace the bank balance from the reconciliation to the bank statement.
8. Trace any normal reconciling items such as deposits in transition or outstanding checks to the next bank statement, looking for any undue delays in clearing.
9. Investigate any unusual or non-recurring items, obtaining documentation of legitimacy. If such items exist, examine prior months reconciliation's to see if the items have been carried forward from month to month.
10. Once reconciling items are verified, compare the "book balance" from the reconciliation to the balance in the accounting records as of the fiscal year-end to the balance reported in the annual financial reports.
11. Count the petty cash fund and determine that the fund is intact.
12. Choose one prior reimbursement of the petty cash fund and examine the documentation in order to establish the validity of items and amounts expended from the fund.

Appendix 2

Checklist for Cash Payments

1. Obtain a list of all bank accounts used to make payments and a list of persons authorized to sign checks or make withdrawals for each account. Compare the list to that from prior years and verify the authorized check signers with associational documents.
2. Obtain the cash disbursements journal or other listing of all disbursements for the year and choose a sample of disbursements for examination.
3. For each item chosen, obtain all supporting documentation and the canceled check.
4. Examine the supporting documents for evidence that the item is a legitimate obligation, and for evidence of approval for payment.
5. Examine the canceled check noting the authorized signature and the payee, and determine that the endorsement is consistent with the payee.
6. Determine the appropriate account to be charged for each item and trace each item to an entry in the accounting records to determine that the correct account was charged.
7. Scan the numerical sequence of checks issued during the year and investigate any missing numbers.
8. Examine all checks listed as “Void” in the checkbook or disbursements journal.

Appendix 3

Checklist for Payroll Taxes

1. Compare actual rates of pay with authorized rates from the minutes.
2. Examine withholdings and deductions from paycheck of staff, and examine documents authorizing any volunteer deductions.
3. Trace all individual earnings record posting to a check register.
4. Examine quarterly payroll tax returns and compare amounts reported thereon to the amounts reported on the employee's W-2 forms. Investigate any discrepancies.
5. Determine that a current Federal Form W-4 and a Form I-9 (Immigration and Naturalization Service) is on file for each person hired after November 6, 1986.
6. Determine that a Form W-2 has been given to each employee (including the pastor and associational missionary), and that the W-2's are correct and properly filed.
7. Determine that a Form 1099 are being given to all individuals who are not employees and paid \$600 or more annually and to all recipients of scholarship funds of \$3,000 or more in one year.
8. Test the payroll to be sure that a real employee exists for every payroll check written.
9. Have total wages been reconciled with quarterly Federal Forms 941, W-2 and W-3?
10. Have Total withholding taxes been reconciled with Form 941?
11. Have Federal and State withholding taxes remitted on a timely basis?
12. Is a current Form W-4 on file for each employee?
13. Trace the total balance of the payroll reconciliation to the financial report.

Appendix 4

Checklist for Property, Insurance and Miscellaneous Items

1. Obtain a master list of all real and personal property owned by the church or association and compare it to last year. Determine that any additions or disposals were properly authorized.
2. For any new items on the list, examine the items to determine that they are present. Spot check older items to be certain they are present.
3. Examine current insurance policies for dates and amounts to determine that adequate coverage exists.
4. Obtain year-end statements for any mortgages or loans and determine the correct year-end balance. Trace this amount to annual financial report.
5. Determine that mortgage and loan payments are up to date.

Appendix 5

ACCOUNTING PRACTICES AND PROCEDURES QUESTIONNAIRE

Question	Yes	No	N/A
1. Is there an up-to-date accounting and financial procedures?	___	___	___
2. Does the financial secretary's or treasurer's activities involve only keeping the records of cash collections and preparing support for disbursements?	___	___	___
3. Are the facilities locked when not in use?	___	___	___
4. Is the accounting records safeguarded at all times?	___	___	___
5. Is a financial oversight committee operational?	___	___	___
6. Are the accounting records and underlying internal controls audited annually?	___	___	___
7. Are all employees who have access to cash bonded?	___	___	___
8. Are those who make contributions encouraged to use checks in making their contributions?	___	___	___
9. Are all checks received endorsed with For Deposit Only as soon as possible?	___	___	___
10. Are all checks deposited as soon as possible after receipt?	___	___	___
11. Is ALL cash received deposited immediately in the bank?	___	___	___
12. Is cash safeguarded in a safe, lockbox, or protective container when at the church or associational office?	___	___	___
13. Are collected funds given to the financial secretary or treasurer for entry into the accounting records, and a copy			

- | | | | |
|---|-----|-----|-----|
| sent to the finance committee for subsequent purposes? | ___ | ___ | ___ |
| 14. Are incoming mail and in-office contributions handled by people not responsible for the accounting records? | ___ | ___ | ___ |
| 15. Has the bank been instructed in writing to never cash checks made payable to the church or association? | ___ | ___ | ___ |
| 16. Are contribution records maintained for the members? | ___ | ___ | ___ |
| 17. Are financial supporters instructed to report any discrepancies in the report of contributions to the church or associational leadership? | ___ | ___ | ___ |
| 18. Are the contribution records reconciled to the total contributions in the accounting records? | ___ | ___ | ___ |
| 19. Are requisition slips prepared for cash disbursements that does not have a standing authorization? | ___ | ___ | ___ |
| 20. Are pre-numbered purchase orders used for all purchases that do not have a standing authorization? | ___ | ___ | ___ |
| 21. Are invoices checked for accuracy before being paid? | ___ | ___ | ___ |
| 22. Is the approval and check for accuracy documented? | ___ | ___ | ___ |
| 23. Are all disbursements, except for minor items, made by serially numbered checks? | ___ | ___ | ___ |
| 24. Is a check protector used? | ___ | ___ | ___ |
| 25. Are at least two signatures required for all checks? | ___ | ___ | ___ |
| 26. Do all check signers inspect all supporting documentation before signing? | ___ | ___ | ___ |
| 27. Are invoices and supporting documents marked canceled or paid when checks are issued? | ___ | ___ | ___ |
| 28. Are all voided checks marked "Void" and retained? | ___ | ___ | ___ |
| 29. Is preparing a check made payable to "Cash" prohibited? | ___ | ___ | ___ |
| 30. Are blank unused checks safeguarded at all times? | ___ | ___ | ___ |

- | | | | |
|--|-----|-----|-----|
| 31. Is a petty cash fund used for minor disbursements of cash? | ___ | ___ | ___ |
| 32. Are vouchers prepared for all disbursements from the petty cash fund? | ___ | ___ | ___ |
| 33. Are transfers between bank accounts always properly authorized? | ___ | ___ | ___ |
| 34. Are reconciliations of all bank accounts prepared monthly by an individual who is not involved in handling cash or signing checks? | ___ | ___ | ___ |
| 35. Is the petty cash fund reconciled on a surprise basis at least once a year? | ___ | ___ | ___ |
| 36. Are the account balances in the books reconciled with the amounts presented in the financial reports? | ___ | ___ | ___ |
| 37. Are valuables (securities, important documents, etc.) kept in bank safe deposit box? | ___ | ___ | ___ |
| 38. Are two signatures required for access to the safe deposit box? | ___ | ___ | ___ |
| 39. Is an updated inventory of securities, valuables, equipment, and other non-cash assets maintained? | ___ | ___ | ___ |
| 40. Are regular reviews made to determine if insurance coverage is adequate? | ___ | ___ | ___ |

Sources

Audit Program for Internal Auditors of Churches, Hartford, Connecticut, Published by the Missionary Society of Connecticut, October 2000.

The financial reports, policies and procedures of the North Pulaski Baptist Association, 251 Indian Bay Drive, Sherwood, AR 72120, 2003.

The Local Church Audit Guide for United Methodist Congregations, Nashville, TN, Department of Internal Audit, General Council on Finance and Administration, 2001.

J. David Carter, *Managing Your Church Finances...Made Easy*, Nashville: Lifeway Press, 1998.



ARKANSAS BAPTIST
STATE CONVENTION

PO Box 552
525 West Capitol
Little Rock, AR 72203

1-501-376-4791
1-800-838-2272
www.absc.org