

**Battershell & Nichols, CPAs
welcomes you to:**

Road Map for Auditing Your Ministry

The presentation will begin shortly...



CPE needed?

Within one week, send an email requesting CPE, complete the course evaluation, and provide the list of CPE codes provided during the presentation to:

info@battershellnichols.com

(Only available for those attending live)

All CPE codes are provided in the presentation via polls.



Remote Accounting Services

- We provide bookkeeping services to churches and Christian nonprofits including:
 - Produce a monthly financial report for leadership
 - Process contributions and bills
 - Record all transactions in the general ledger
 - Reconcile bank accounts, credit cards, and close the books each month
 - Process payroll and file all quarterly and annual payroll forms
 - Provide budget and cash flow projection oversight
 - Give assistance with internal controls

Remote Accounting Services

- Why do we provide this service?
 - With online software solutions dramatically improving, outsourced bookkeeping has become a popular alternative to in-house bookkeeping
- Top reasons our clients use our remote accounting services:
 - Managing finances distracts the organization from its mission
 - Leadership and members have increased confidence in their finances
 - Tax and accounting regulations are complex and changing faster than ever
 - They want a trusted advisor to provide CPA oversight

DISCLAIMER:

- *The author is not engaged by this text or webinar in the rendering of tax, accounting, or similar professional services.*
- *While the tax, and accounting issues discussed in this material have been reviewed with sources believed to be reliable, concepts discussed can be affected by changes in the law or in the interpretation of such laws since this text was printed. For that reason, the accuracy and completeness of this information and the opinions based thereon cannot be guaranteed.*
- *Before taking any action, all references and citations should be checked and updated accordingly.*

Road Map for Auditing Your Ministry

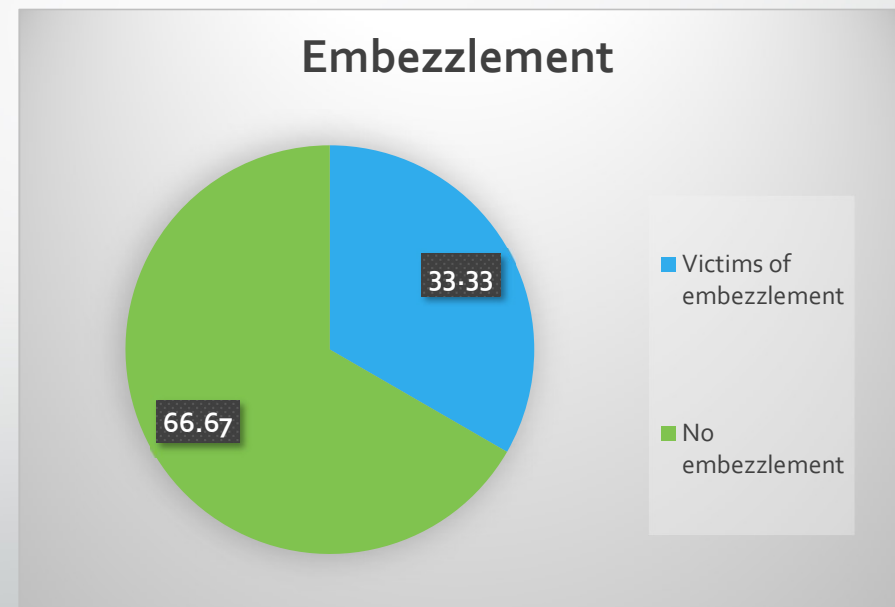
November 16, 2022

By: Robin Nichols, CPA and Rick Battershell, CPA

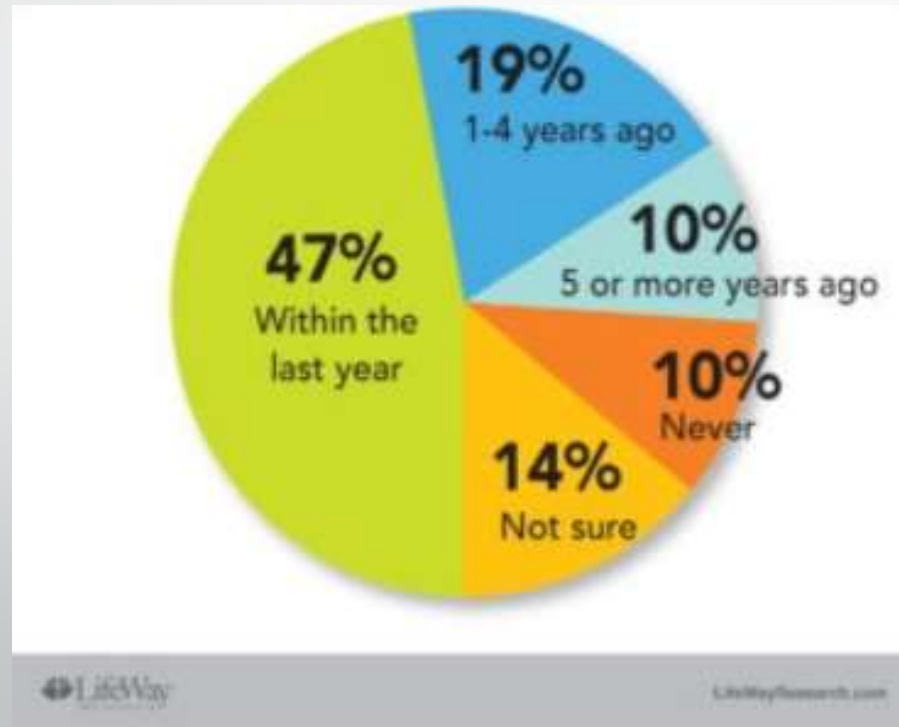


How embezzlement is affecting the Church

- According to Religion Unplugged, 1 in 3 churches will be victims of embezzlement, but 27% will not report the crime.
- Embezzlement will cost churches \$170 billion in the year 2050 if current trends continue



When was the last time your church had a complete audit of its finances?



Biblical Basis

- 1 Cor 14:33: God is not a God of disorder but of peace
- 2 Cor 8:18-21: And we are sending along with him the brother who is praised by all the churches for his service to the gospel. What is more, he was chosen by the churches to accompany us as we carry the offering, which we administer in order to honor the Lord himself and to show our eagerness to help. ***We want to avoid any criticism of the way we administer this liberal gift. For we are taking pains to do what is right, not only in the eyes of the Lord but also in the eyes of men.***

Board Responsibility

- Financial oversight
- Procedures in place to protect against:
 - Misappropriation of assets
 - Misdirection of donor restricted contributions
 - Excessive compensation
 - Improper related party transactions
 - Violations of federal tax law
 - Improper private benefit



Board Responsibility

- Requires devoting sufficient time, resources, and attention to financial oversight
 - Ensure that top management carries out its duties of effective and healthy financial operations
 - Legal liability of their actions and decisions - personnel, etc.
 - Question things that look unusual or that they do not understand until satisfied
 - Understand the level of service (procedures) provided by outside accountants

Treasurer/Finance Committee



- Managing the financial operations
- Providing current financial reports
- Know that financial controls are in place and operating effectively
 - Segregation of duties
 - Internal controls

The Real Cost of Economic Fraud

- Often the least significant loss is the money
 - Association of Certified Fraud Examiners (ACFE) 2022 study = fraud loss avg= 5% of revenue
 - Median loss per case = \$117K
- Loss of trust in your ministry
- Emotions: Anger, grief, betrayal, discouragement

Benefits of Internal or External Audits

- Promote confidence in financial records
- Protect the staff who handle church funds
- Protect church assets
- Promotes integrity in handling the finances through accountability
- Verify that controls and procedures are followed
- Raises the participants' level of awareness about internal controls and procedures
- What gets measured gets accomplished

Discovering Fraud (ACFE 2022 study)

- 42% through tips
 - With Fraud Hotlines: \$100K median loss over 12 months
 - Without Hotline: \$200K median loss over 18 months
- 16% internal audits
- 12% by management review
- 6% by examining support documents
- 5% by reconciling accounts
- 4% by external audits



Internal Controls - What Are They?

- Procedures adopted to:
 - Safeguard assets
 - Check the reliability and accuracy of financial records
 - Ensure compliance with financial policies of the ministry
- Trust but verify
- Purpose – to increase accountability, transparency, and financial integrity of financial operations

Internal Controls

2022 Report to the Nations found:

- 29% of fraud cases occurred because of no internal controls
- 20% of cases because of overriding existing controls



- Certain procedures can be built into the accounting process to minimize the chance of errors or theft
- Cost vs Benefit - You cannot practically design a perfect system that detects and prevents all errors. But many low cost measures *can* be implemented.



Key Causes of Weak Internal Controls

- Frequent override of established policies and procedures
- Lack of leadership support
- Poor segregation of duties

Internal Controls

- **Self-Assessment** – if you would like a self-assessment of internal controls, please request this at

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Separation of Duties

- Financial transactions are not handled by only one person from beginning to end
 - Requiring 2 sets of eyes on every transaction
- Divide up the financial activities performed:
 - Authorization of transactions
 - Recording of transactions
 - Custody of assets



Red Flags

- Refusing access to records
- Coming into a sudden inheritance
- Skipping vacations
- Overriding internal controls
- Attempts to dodge or direct an internal audit
- Working regular overtime
- Carrying excessive cash
- Bouncing personal checks
- Turning down promotions
- Maintaining high life style
- Accounting personnel with check signing authority



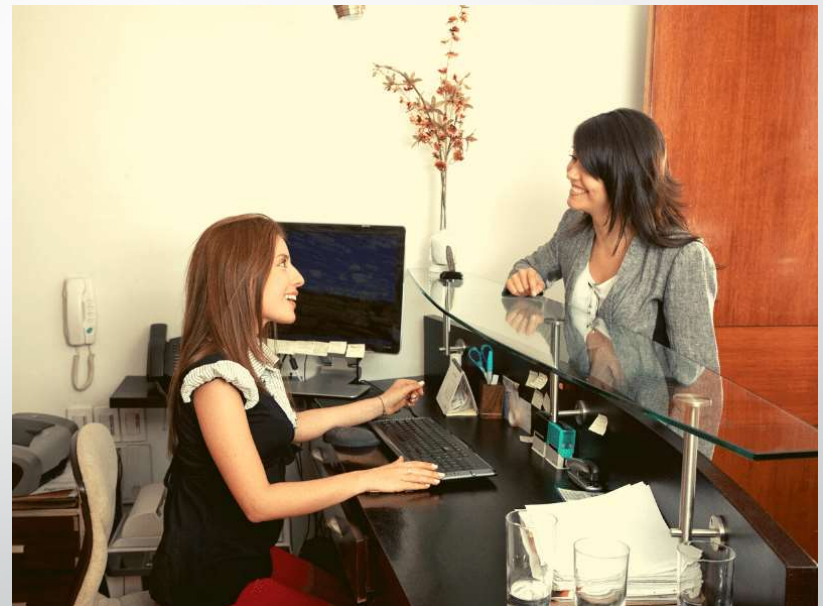
Auditing Specific Areas:
Cash Receipts

Cash Receipts

- Goal of Internal Controls
 1. All cash and checks are deposited in the organization's bank account shortly after receipt. (Loss of cash before it reaches the bank is usually not caught in audits, only what gets recorded.)
 2. Contributions are accurately accounted for and reported to donors periodically.
 3. Separation of duties to protect the church and the staff involved.

Cash Receipts – Fraud Case #1

- Receptionist Duties:
 1. Opened all mail
 2. Restrictively endorsed all checks in the name of ministry
 3. Made the deposit
 4. Recorded these contributions in the donor database



Cash Receipts – Fraud Case #1

- Receptionist – what happened:
 1. Opened a bank account in name of ministry, she was the signer
 2. Restrictively endorsed out of town checks to this account
 3. Recorded these contributions in the donor database
 4. Deposited \$300,000 over 6 years

Cash Receipts – Fraud Case #2

- Treasurer – what happened:
 1. Count team completed the count of offerings, signed count sheet, gave one copy to treasurer, kept copy for their records
 2. Treasurer removed cash, replaced with his personal check
 3. Recorded his check as contribution and issued receipt for tax purposes

Cash Receipts – Fraud Case #2



- Treasurer – variations:
 1. Members hand treasurer check after offering counted
 2. He adds check, removes cash

Cash Receipts – Fraud Case #3

- Count team collusion
 1. Church had multiple count teams that rotated once per month
 2. 2 to 3 counters each week
 3. One team pocketed the “unidentified” cash each week
 4. 3rd Sunday offerings were always lower, and unidentified cash always equaled \$0 (auditor spotted anomaly)

Cash Receipts – Fraud Case #4

- Treasurer:
 1. Took offering home every Sunday, counted, deposited, and recorded
 2. Medium sized church with modest growth in attendance, but total offerings had little change each year
 3. Questions arose, duties of counting and depositing changed, offerings increased immediately
 4. Embezzled \$50-\$70K in last 12 mos

Cash Receipts – Controls

- Evaluate cash receipts controls
 - At least two unrelated persons always in control of the offerings or other deposits from the time of receipt until deposited in the bank?
 - Are counters rotated weekly or monthly?
 - Is the person who handles deposits someone other than the one making accounting entries and donor records?
 - Are funds deposited in the bank in a timely manner?
 - Controls for handling of non-offering revenues (daycare tuition, camp registration, retreat fees, etc.)

Cash Receipts – Controls

- Evaluate cash receipts controls
 - Are total deposits reconciled to contributor records?
 - Drop safe available for deposits during the week?
 - Can deposits be adequately traced to donor records and pledge tracking system, if applicable, including cash given by unidentified donors?
 - The church may want to keep copies of checks and/or offering envelopes until donors have had time to verify their giving statements for the prior year.

Cash Receipts - Testing

- Sample selection
 - Include all bank and financial institution accounts
 - Include all designated and special funds
 - Pledge transactions
 - Credit card and Internet deposits
 - Electronic funds transfers
 - Debit entries to cash accounts
 - Method:
 - Select several deposits to test.
 - Perhaps test 3 to 4 months of deposits

Cash Receipts – Testing

- Verify the clerical accuracy of offering count and other deposit forms
- Review deposit count sheets for signatures of at least 2 persons present who participated in the counting
- Are count sheets (or summary of receipts forms) supported by a list of checks (donors and other receipts) deposited that week?
- Agree the deposit to the bank statement or stamped deposit
- Trace the deposit to ensure it was properly recorded in the correct general ledger account(s)
- For contributions, trace several donors' contribution into the contribution records for that donor to determine that it was properly recorded

Cash Receipts – Testing

- Review a few donor contribution reports to verify the amount of cash and checks received
- Calculate trend in average giving per attendee
- Calculate trend in giving per week
- Select dates at random during the year
 - Is there reconciliation between the total deposit and the donor records?
 - Are unidentified cash donations and other receipts (retreats, sales, etc.) accounted for?
- For donor restricted contributions:
 - Verify that the organization is properly tracking funds and could easily account for the increases, decreases, and the current balance.

Cash Receipts – Testing

- Review documentation for non-offering revenues:
 - Retreat, camp, class fees vs attendance lists
 - Daycare/preschool tuition receipts vs. registration records





Auditing Specific Areas: **Cash Disbursements**

Cash Disbursements

- Goal of Internal Controls
 1. Disbursements are authorized by the appropriate people
 2. Pay for valid church expenses
 - Actually received the items or services listed in invoices
 - Pay the appropriate amount
 - Only pay for an item once
 - No unauthorized use of church credit card
 3. Obligations are paid in a timely manner
 4. Separation of duties to protect the church and the staff involved

Cash Disbursements – Fraud case #1

Business Administrator in Indiana

- Business administrator for 4 years
- He was signer, but church required 2 signatures (forged other leader's signature)
- Destroyed checks and credit card statements
- Falsified financial records
- Recorded as health insurance
- Used credit card 300 times for personal purposes
- Approximately \$350,000 stolen
- Prior church – misused credit cards, no charges

Cash Disbursements – Fraud case #2



Pastor reimbursements

- Not a check signer, no access to records
- Expense report submitted with wad of multi-stapled unorganized receipts
- Bookkeeper bullied into accepting report when she tried to verify total
- Submitting receipts and statements for same expense, plus many personal “business meals”
 - Represented thousands of dollars

Cash Disbursements – Fraud case #3

Purchaser goes to Costco

- Responsible for purchase and distribution of supplies – paid in cash
- Over 2 year period, he ordered unnecessary supplies, then returned many for cash refunds
- Employer contacted when a Costco employee was inquiring whether there was a problem with merchandise in light of volume of returns

Cash Disbursements – Fraud case #4

- Bookkeeper noticed several receipts missing
 - Vendor listed on statement, but no detail
 - Purchaser buying gift cards, along with other items at grocery store and using personally
- Recommend not reimbursing buyer's credit card without adequate receipts



Cash Disbursements - Testing

- Sample selection
 - Include all bank and financial institution accounts
 - Include sample of petty cash transactions
 - Debit & credit card transactions
 - Automatic transactions
 - Electronic funds transfers
 - Employee reimbursements
 - Method:
 - Select 30-60 disbursements at random.
 - Perhaps test 2 to 3 months (smaller organizations)

Cash Disbursements – Testing

- Properly authorized?
- Adequate documentation to support the amount of the disbursement?
- Authorized signer? Properly endorsed?
- Recorded in the correct account as listed?
- Inquire = blank checks ever signed?

Cash Disbursements – Credit Cards

- Is support for the item purchased a valid invoice, and not just an order that could later have been canceled?
- Is this for an item that can be verified as used in the ministry?
- Review history to see that multiples of the same expense haven't been paid for in a relatively short time.

Cash Disbursements: Electronic Fund Transfers

- All transfers should be supported, reviewed and approved before making transfer
- Those authorizing should initial and make note that it is being paid by EFT
- Separation of duties – accounting for and initiating transfer, different people





Auditing Specific Areas: **Bank Reconciliations**

Bank Reconciliation

- Goal of Internal Controls
 1. Reconciled soon after the end of the month
 2. Reconciling items are properly reported and any unusual item is reviewed
 3. If prepared by someone with accounting duties, the bank reconciliation is reviewed by the Treasurer or other appropriate person in authority, and initialed and dated by the reviewer.

Bank Reconciliation – Fraud case #1



- “Bob” the accounting clerk
 1. Organization used US Postal Service for frequent mailings, several checks per month
 2. Bob would print checks to US Postal Service
 3. After supervisor signed, he was able to change payee name on check to his own
 4. Changed name on checks back to US Postal Service when bank statements arrived

Bank Reconciliation – case #2

- Failure to reconcile
 1. Church accepted credit cards, but had hard time reconciling
 2. Management did not insist on reconciliation
 3. Deposit was more than bookkeeper expected, but could not reconcile, so gave up and added income
 4. 9 months later bank notified church of mistakenly depositing different business' credit card receipts of \$60K

Bank Reconciliation – Testing

- Sample selection
 - Include all bank and financial institution accounts
 - End of year & at least one other month
- Compare balances on bank reconciliation with accounting records and bank statements
- Determine when the following cleared the bank:
 - Outstanding deposits
 - Outstanding checks
- Unclaimed property laws to consider

Loan Reconciliation – case #3

- Failure to reconcile
 1. One church had issued several bonds and had been making payments for years
 2. We reviewed original documents and amortization schedules
 3. Several bond holders continued to be paid, even after they were paid off for a few years

Payroll



- Goal of Internal Controls:
 1. Employees are paid based upon approved compensation amounts
 2. Time sheets are filed and approved
 3. Tax payments (deposits) are made timely
 4. Tax reports are filed timely
 5. Personnel records are adequately maintained
 - Eligibility to work in USA documented

Payroll – Testing

- Select one or more payrolls
- Pay rates are adequately supported by approved time cards or employment contracts
- Taxes were properly withheld and deposited in a timely manner
- State and federal tax forms were accurate and completed in a timely manner
- Examine support for the amount designated as housing allowance for pastors
- Employee benefits paid in a timely manner

Payroll – Testing

- Personnel files:
 - Current pay rate authorization
 - Evidence that pay rate is communicated to employees
 - File includes forms required by regulatory authorities such as W-4, I-9
 - Evaluate the safeguarding and confidentiality of personnel files



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Auditing Specific Areas: **Other Areas to Consider**

Separate Checking Accounts

- Youth pastor
- Women's ministry
 - Protect funds
 - Streamline the process
- RISKS – able to make purchases without accountability to anyone
- Recommendation – require same procedures and controls for every ministry, all reported



Financial Reports

- Goal of Internal Controls:
 1. Reliable and accurate
 2. Provide a complete financial picture of all aspects of the organization
 3. Budget variances adequately explained and approved
 4. Provided in a timely manner
 5. Distributed to the appropriate people
 6. Each item on the balance sheet exists
 7. Each balance sheet account balance is adequately supported
 8. Detailed ledger review monthly

Financial Reports – Testing

- Review reports submitted to board & finance committee
- Compare selected amounts to general ledger detail
- Change in cash position can be reconciled from information provided
- Compare the support documentation for assets and liabilities including bank statements, brokerage statements, fixed assets listings, accounts payable...
- Review discussions and explanations of budget vs actual
- Review the support for property and equipment balances

Other Testing

- Assets of the organization
 - Annual review of asset list (e.g. over \$500 or \$1000)
- Gift cards for use by the organization
 - Control ledger reconciling use
- Tuition and accounts receivable
 - Separate duties: billing and collecting
 - Require all adjustments and refunds to be properly supported
 - Management approval for adjustments and write-offs
 - Credit card refunds posted to original card

Other Policies & Items

- Prior Audits—recommendations implemented or adequately responded to?
- Accounting policies and procedures documented?
- Disaster Recovery Policy for financial data (including offsite backups)
- Data Security - Determine who has access to computers, checks, purchase orders
- Conflict of Interest Policy – annual verification of compliance
- Insurance Coverage - Examine all insurance policies and a schedule of insurance coverage
- Record Retention Policy
- Separate bond for persons handling money

Who Performs Self-audit?

- **Selection**
 - Generally 3 to 5 members
 - Majority are non-employees/ all non-management
- **Qualifications**
 - Independent from the accounting function
 - Financially literate – familiar with financial statements, bank statements, invoices, etc. (knowledgeable business people)
 - Able to inquire about pertinent issues
 - Commitment, time, availability
 - Knowledge of accounting and auditing helpful

Self-Audit Follow Up?

- Board Report
 - Directly from and signed by audit committee
 - Finance staff not in that meeting – Q&A
 - Don't expect perfection – reasonable
- Follow up in 6 to 12 months

What Type of Audit?

- Washington State audit required for nonprofits with \$3M gross receipts (some exceptions)
- Review your constitution or bylaws
- Internal audit
- CPA services
 - Audit
 - Review
 - Compilation
 - Agreed Upon Procedures



Other Resources

- www.EFCA.org
- ChurchLawandTax.com
- **Integrity at Stake** by Rollie Dimons
- **Report to the Nations on Occupational Fraud and Abuse – 2022 Global Fraud Study**
 - https://legacy.acfe.com/report-to-the-nations/2022/?_ga=2.244144133.1652113038.1666221948-493520148.1666221948

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Next Webinar



Wednesday December 14, 2022

**2022 Year End Update:
Compensation Reporting**

Thank you for joining us

Please reach out with any questions:

info@battershellnichols.com

(253) 839-1620

