

**AUDIT PROCEDURES FOR AUDIT COMMITTEES TO FOLLOW WHEN PERFORMING A YEAR-END AUDIT OF THE CHURCH'S BOOKS**

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The easiest way of doing the audit is to create teams of two but is not required. Each team takes a section of these procedures and begins their review. They report their findings to all team members at the end of the audit. You would need 5 teams of two. The Treasurer, Bookkeeper and Administrative Assistant can pull files for the teams and help answer questions that arise.

For the examination of: CASH

Purposes of procedures

To obtain assurance as to:

- (1) The proper existence, ownership and availability of recorded cash;
- (2) Proper cut-offs of receipts and disbursements as of year-end.
- (3) Proper recognition of reconciling items between book and bank balances.

Audit procedures

(1) Cash receipts: **For all church funds**

Please select any two months out of the year and the month of December to perform detail audit work. **For each of the three months selected:**

- a) Vouch (Agree) that the Sunday plate and pledge collections per the count sheets agree with the deposit slips. *Count sheets should be prepared by the Sunday collection counters. Compare dates to determine the timeliness of deposits. There should be no time lag!*
- b) Vouch "other" or miscellaneous receipts (other than Sunday collections) to the appropriate source documents and to the deposit slips.
- c) Reconcile deposits listed on the bank statements with deposits listed in the cash account per the detail general ledger for the months being tested.
- d) Compare dates and amounts of weekly deposits from the bank statements to the input date of the information to the General Ledger to determine timeliness.
- e) Trace the monthly cash ending balance from the General Ledger to the monthly cash balance on the Statement of Financial Position (balance sheet).
- f) For pledge income test work, please refer to instructions on the REVENUE procedures, page 5.
- g) Verify the monthly bank reconciliation has been done promptly and reconciles to the monthly cash balance per the General Ledger.

(2) Cash disbursements: **For all church funds**

**For the months selected for detailed audit work in step (1) above:**

- a) On a test basis, compare cash disbursements entries with canceled checks as to number, date, payee, and amount and with other charges appearing on the bank statement.
- b) Review canceled checks for authorized signers (there should be more than 1) and for the required number of signers. (*ex: 2 signers for checks greater than \$500*) Review canceled checks for irregular endorsements and alterations.
- c) Trace postings from cash disbursements to the monthly financial statement. Determine if the classification of expense is proper. ***Classification should be according to the expense's function, not according to the amount of the budget available!***

For the examination of: **CASH** (continued)

(3) For the nine months NOT selected for detailed audit work and for JANUARY 2020, scan the cash account entries and credits and debits on bank statements for any **unusual** items. Investigate any found and resolve.

(4) Obtain bank reconciliations for all bank accounts as of December 31, 2019 to verify the year-end balances:

- a) Trace deposits in transit (not yet posted on the bank statement for December) shown on the bank reconciliation to the January bank statement and ascertain that the time lag is reasonable.
- b) Ascertain that outstanding checks, which are material in amount and did not clear the bank by January, are proper.
- c) Ascertain that any other reconciling items other than (a) or (b) above are proper.
- d) Determine that the bank reconciliations are being performed on a timely basis throughout the year.

(5) Compare cash deposits to the bank statements for the last five days of December and the first five days of January for timeliness in deposits and for recording in the proper month.

(6) Agree book balances per bank reconciliations to the December 31st Statement of Financial Position (balance sheet) and to the total cash amount shown on page 3 on the bottom of the parochial report.

(7) Ascertain the number of bank accounts maintained and the purpose for which each is kept. Is the number reasonable and manageable? Is there more than 1 authorized signer on each account?

(8) Write down any suggestions for improved or better procedures or any corrections needed in internal controls in regards to cash.

**Things to consider for internal controls:**

a. There should be two check signers on every check or at least on checks over \$XXX dollar amount. (Example: The diocese currently requires two signers for checks over \$5,000 for its accounts.)

b. If at all possible, the bank reconciliation should not be performed by a check signer. If it is, have someone else occasionally review the bank reconciliations throughout the year.

c. Bank reconciliations should be done for every month, on a timely basis, for all accounts.

d. Per IRS guidelines on December donations:

1. If a check is dated for 2019 but is received in 2020:

By collection/or handed in: It is a 2019 donation.

By mail: check postmark on envelope. If postmarked in 2019, then 2019 donation.

If **postmarked in 2020**, then **2020** donation  
no matter what the check date is!

**Helpful hint: Keep the envelope for those donations as proof.**

e. See if cash receipts and disbursements duties are as segregated as they can be.

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For the examination of: **INVESTMENTS including ENDOWMENTS**

Purposes of procedures

- (1) To confirm the physical existence and proper ownership of the investments.
- (2) Ascertain that dividends, interest, gains or losses are properly recognized.

Audit procedures

- (1) Obtain from the Treasurer or prepare a schedule of investments and related income for the year. The schedule should show beginning balances and rollforward to the ending balances at year's end, showing interest and dividend income, fees, capital additions and any other miscellaneous items.
- (2) Agree the year-end balances of the investments to statements issued by "outside sources" such as the bank, investment companies, Wall Street Journal or Yahoo Finance. Agree beginning balances to the investment schedule in the prior year's audit work papers.
- (3) Verify income earned from securities by tracing to the statements or by recomputing.
- (4) Recalculate any realized gain or loss from sales or purchases (on a test basis if numerous.)

For investments **other** than securities that are traded:

- (5) Recompute and trace to source documents such as bank statements or investment statements, on a test basis, the interest income and the expenditures of the investments.

*FASB (the Financial Accounting Standards Board) has specified that equity investments should be reported at their **fair value only**. The Fair Value is adjusted each year for value increases and decreases by calculating UNrealized gains and losses. Realized gains and losses are calculated when the securities are sold. Realized and unrealized losses on investments may be netted against realized and unrealized gains on the statement of activities (income statement).*

*Therefore, it is **NOT** proper to record equity investments only at **lower** of cost or market value.*

For the investment schedule:

(6) Recalculate totals on the schedule. Verify the December 31<sup>st</sup>'s numbers are the Fair Market Value. Trace interest income to the Statement of Activities (income statement) and total investment amounts to church's Statement of Financial Position (balance sheet). Agree the Statement of Financial Position to the investment amount listed on page 3 on the bottom of the parochial report. The interest income, if used for operations, should be shown on page 2 of the parochial report workbook. Then agree the workbook number to the submitted annual Parochial Report.

(7) State any suggestions to the recording of investments or improvements to the accounting system.

**Things to consider for internal controls:**

- a. Who determines the investment strategy? Is it following diocesan and national church guidelines?
- b. Does it take more than one person to authorize a change in investment mix or a change in who manages/controls the money?
- c. Are the investment statements reviewed promptly?
- d. Has the Vestry/Mission Council considered investing excess funds, investments or endowments in the Trustees of the Diocese's Consolidated Growth & Income Funds currently managed by PNC Bank? Diocesan Canon XVI, Section 14 (b) states that all endowment funds, other trust and permanent funds for Church purposes may be deposited with PNC Bank under the investment strategy of the Diocesan Trustees.

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For the examination of: **REVENUE & EXPENDITURES**

Purposes of procedures

To determine that:

- (1) The amounts included in income and expenses are valid and properly recorded;
- (2) Whether any amounts have been restricted or designated and if so, have been properly handled.

**DEFINITIONS**

The governing rules issued in the Statement of Financial Standards No. 117, *Financial Statements of Not-for-Profit Organizations*, classify funds in categories of “net assets.”

The Balance sheet is referred to as the “Statement of Financial Position.”

The Income statement is called the “Statement of Activities”

Audit procedures

- (1) Review the sources of revenue and the types of expenses per the Statement of Activities. Investigate any items that seem unusual.
- (2) Verify that any temporarily or permanently restricted funds have supporting documentation such as Vestry Minutes, donor letters...that spell out the restrictions.
  - a) If the time restrictions have passed or the restriction has been met, then determine that temporarily restricted funds have been properly spent.
  - b) Ascertain that any related restricted “expenses” are properly classified on page 3 of the parochial report. These “expenses” are shown as “Net Assets Released from Restrictions” on the Statement of Activities.
- (3) Pledge revenue
  - a) Select a "X" number of the church's year-end pledge statements mailed to parishioners. *(The Treasurer should have kept one complete set of the statements mailed.)* The number selected will depend upon the total number of pledging units. Try to choose the higher dollar pledges to verify. Since this is the only test of pledge income, try to select statements with pledge dollars that will total to at least 30 % of the total pledge income.
  - b) Trace three or four payments, if a monthly giver, or trace all payments if semiannual or annual giver to (1) the Sunday count sheet AND (2) the stamped deposit slip for all selected statements.
  - c) If credit cards are used, trace to bank statement deposit (shown as lump sum) then back to the terminal's charge slip.
  - d) Follow up and resolve any discrepancies.
  - e) Agree pledge income per financial statement to the parochial report, page 3, Line 3.

**Analytical Review:**

*Have the Treasurer prepare an analytical review showing current year, prior year's audited numbers and the difference as either dollar amount or percentage or both. It would be extremely helpful if the Treasurer wrote comments on any significant differences between the years shown.*

(4) Compare expense and revenue accounts with those of the preceding year, and obtain explanation and ascertain propriety of significant fluctuations from the past year to the current year.

(5) Agree any other type of revenue, besides pledge income, on the financial statements to the parochial report. Agree the total of "Letter B" on the parochial report to total revenues per financial statements.

(6) Agree operating expenditures to Letter E, page 3, of the parochial report and all other expenditures to the proper line number on the parochial report.

*Accounting note: On loans: Payment of the principal reduces the liability balance on the Statement of Financial Position and therefore is not currently shown anywhere on the parochial report. Payment of the interest on the loan is included in "All other operating expense" on page 7 on the parochial report workbook.*

(7) Write down any improvements or suggestions that would help the internal control system or accounting system.

**Things to consider for internal controls:**

- a) Vestry or Mission Council minutes should be concise and detailed as to the receiving and/or spending of temporary or permanently restricted money.
- b) Pledge statements must be mailed as of December 31, 2019 and should be mailed quarterly (or semi-annually for smaller churches) during the year. These statements should be considered tax receipts and **need to include the statement, if true, "no goods or services were provided only intangible religious benefits." Each contribution greater than \$250 needs to be detailed.**

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For the examination of: **PAYROLL**

Purposes of procedures

To ascertain that:

- (1) All payroll expenses have been properly recorded and distributed.
- (2) There have been no processing errors.
- (3) Proper tax returns have been prepared and filed.
- (4) Proper year-end tax forms have been issued.

Audit procedures

Please select any two months of the year and the month of December to perform detail audit work.

**(1) For each of the three months selected for detailed auditing:**

a) Test details of payroll to the most appropriate supporting data, such as Vestry or Mission Council minutes, as to:

- 1) Names
- 2) Hours work per week/month (part or full time)
- 3) Deductions from pay, besides tax withholdings
- 4) Any other financial payments

Ascertain that employees were compensated during the year in accordance with Vestry's or Mission Council's authorization. Annual salaries should be compared to the official Minutes and adoption of the budget.

b) Test the extensions, the totaling, and the summaries of the payroll journal for the months selected.

c) Test the distribution of payroll to the different accounts and trace to monthly financial statement.

d) Compare payroll entries with canceled checks as to number, date, payee, and amount, and scrutinize canceled checks for authorized signatures, irregular endorsements and alterations.

(2) For the nine months of payroll NOT selected for detail auditing, scan the payroll register for unusual items or individuals and investigate any found.

(3) Review the 941 tax returns for Federal and FICA withholdings and the tax returns for state and any city taxes for the year. Agree W-2's to the approved budget and the December financial statements. Verify that all cash allowances, except for the clergy housing allowances, are included on the W-2's.

**IRS Note on Reporting Housing Allowance at year-end:** There are two acceptable ways to report the annual Housing Allowance: (1) On the W-2, in **Box 14** with the words "Housing Allowance".

(2) On letterhead, in a letter to the clergy stating the amount of housing allowance given to them during the year.

**Accounting note:** While parochial clergy receive a W-2 at year-end for income tax purposes for being an employee of the church, almost all clergy pay SECA (self-employment tax) rather than FICA. Therefore, on the W-2, social security should not be withheld and no dollars should be in the boxes for "Social Security tax withheld" or "Medicare tax withheld". Nor should any wages appear in the boxes titled, "Social Security wages" or "Medicare wages." **Any SECA reimbursement (or allowance) from the church should be included in the total Federal wages shown on the W-2.**

(4) State suggestions for improving payroll accounting system or internal control system.

**Things to consider for internal controls:**

a) Parochial clergy received a W-2 not a Form 1099 at year-end.

b) Anyone paid \$600 or more, and not considered an employee, received a Form 1099Misc. This includes supply clergy.

c) Pension contributions by the lay employees, if applicable, were deducted before Federal & state taxes, but included for FICA calculations.

d) Contributions to pensions or annuities withheld from lay salaries are shown on the W-2, Box 12 with an "E" preceding the number.

e) In employees' payroll folders should be an I-9, required by the Federal Government. Also in the file should be a W-4 for federal tax withholdings, and a State of Ohio IT-4 for state withholdings.



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For the examination of: **GENERAL BUSINESS**

(1) Examine the Financial Section of the minutes of the Vestry or Mission Council meetings (or Finance Committee, whichever is appropriate for your church) from January through December.  
*Note: Some of these procedures should have been done in accordance with the Revenue or Payroll audit procedures.*

a) Determine that authorizations and limitations established by the Vestry were in accordance with any "unusual" transactions recorded on the books.

b) Note significant events reported in the minutes such as large gifts, or gifts received with restrictions and follow-up these events in the examination of the financial records. Verify the expenditure of the money was according to the donor's wishes or if not yet spent; the funds are recorded separately from operating monies. (This money does not have to be physically separated.)

c) Note any monies temporarily restricted for a specific purpose by the Vestry or Mission Council. Review the expenditure of the funds and verify if it was in accordance with the Vestry's or Mission Council's instructions.

(2) Determine that **all auxiliary organizations'** financial statements have been audited. Show separately but on the same audited church financial statements those organizations, which are **both**:

a) Controlled by the church. "Control" is defined as direct or indirect ability to determine the direction of the management and policies. AND

b) Entities who solicit funds in the name of and with the approval of the church, and where substantially all the funds solicited are intended by the donor to be used by or for the church.

(Examples: Altar Guild, ECW, Men's Clubs, Choir...)

(3) If a computer is used for processing any part of the financial data, perform the following:

a) Review storage of the **year-end** computer financial records. The best possible place is off-site such as a safety deposit box. Second best would be in a fireproof box in a safe.

b) Inquire as to the normal backup schedule of the financial data. Daily? Weekly? Monthly? How much information would be destroyed and need to be recreated if the system failed or disaster struck? Is the daily backup (not year-end's) kept in a safe, fireproof place?

(4) Verify that the Federal forms I-9 and W-4 have been prepared for all new employees. All current employees should have an I-9 on file if hired after 1986 along with a current year W-4.

(5) Make sure that the amounts listed on the parochial report financial section, page 3, agrees to the December 31<sup>st</sup> financial statements and the numbers audited. (*This should have been done as part of each individual audit section.*) Verify **all** church funds are included in the parochial report data.

(6) Prepare a list of suggestions for improvements in the accounting system per the audit program.

**Things to consider for internal controls:**

a) Is the Treasurer preparing monthly financial statements or regular interim financial reports? Are the statements in proper format and are easily understood by the reviewers?

b) Verify the Treasurer is bonded as required by the National Church's Canons.

c) Was the parochial report filed by the March 1 deadline? Are there any revisions to the parochial reports that need to be made promptly to the Diocesan Finance Department by the September 1<sup>st</sup> deadline? (Revisions may affect your assessment calculation. No revisions will be accepted after September 1<sup>st</sup>.)

d) Is sales tax being paid on church purchases? It shouldn't be. Purchases should be handled by one authorized person. If not feasible, the buyer should at least take a signed sales tax-exemption form with them. Consider a policy where sales tax will not be reimbursed to the buyer.

(7) Prepare an opinion of the audit committee that the financial statements present fairly the financial position of the Church for the year ended December 31, 2019. ***Use the standard opinion required by the Diocesan Finance Department. The signed opinion is required to be in diocesan offices by September 1st.***

(8) Summarize improvements to internal controls that were suggested during the audit. These suggestions must be included with the audit opinion sent to the diocese.