

Church Budget Preparation and Management

Local annual Budget preparation

- Why establish a Budget?
 - To control and measure spending; expose fraud or financial problems in the church; and because the Manual requires it.
- Who should be involved in the preparation of the Budget?
 - Board members, ministry leaders and the Pastor provide input; Treasurer
- What should be included in the annual Budget?
 - Projected income and expenditures
 - Decide how detailed your Budget will be:
 - Simple, using only a few general accounts for income and expenditures:
 - Church Income, District Budgets, Local Ministry, etc., similar to how the local church reports to the District at year-end
 - Complex, using more detailed accounts:
 - Income accounts such as Tithes, Building Fund, Sunday School Donations, Missions, etc.
 - Expenditure accounts such as WEF, Pension & Benefits, District Budget, Education Budget, Camp Expense, Hospitality, Electricity, Pastor Salary, Pastor Benefits, Insurance, etc.
- How do you prepare an Annual Budget?
 - Use past history as a starting point, preferably the last 3 years actual income and expenses
 - Based upon input from others, add to the average calculated above a number based on updated information, e.g., the insurance premiums increased or you gave the Pastor a raise. Or adjust the number based upon what the ministry leaders need and/or believe the Lord will provide
 - The Budget must balance. The projected income should equal the projected expenditures
- When do you prepare and use your Budget?
 - Annually, during February and March, formally adopted by the Board
 - Use budget-to-actual reports monthly, along with Balance Sheet and Statement of Revenue and Expenditures (P&L).

CHURCH FINANCIAL BEST PRACTICES

Internal Control Vital for Prevention of Fraud in the Church

While it is impossible to completely eliminate the risk of fraud, the church can take steps to lower the risk of it occurring, and make it easier to detect if it does occur. Fraud may happen when a person with a financial need sees a way to take church funds without being caught. The Church Board should consider development of *written* policies and procedures in order to control the opportunity for fraud. While fraud can occur during the weekly collection of the offering, most fraud happens after the funds are deposited into the church bank account.

Sound Internal Controls are the foundation of fraud prevention. Internal controls are essentially checks and balances to hold people accountable, and include segregation of duties, approval of expenses, background checks, and timely periodic (e.g., monthly and annual) reviews of financial reports and bank reconciliations.

1. Segregation of Duties – in general, this means that one person is not performing more than one of the following tasks. For smaller congregations, this can be quite difficult if not impossible. However, if one person is performing two or more of these tasks, additional controls can be put into place to hold them accountable, and thus reduce the risk of fraud. **
 - Receiving, counting, handling offering (2 people) (See “More on Handling Cash” below.)
 - Preparing bank deposits (2 people)
 - Recording cash receipts and disbursements into the bookkeeping system (Treasurer or Bookkeeper)
 - Approving expenditures (Church Board)
 - Paying bills via manual check or electronic payment (Treasurer or Bookkeeper)
 - Signing checks – 2 signers (Treasurer, preferably if not Bookkeeper, and other person on Finance Team; never Pastor)
 - Reconciling bank accounts monthly, including investment accounts (Treasurer)

**Additional controls that may be added are *monthly* review of all disbursements (checking account register) by the Board, an annual Internal Audit conducted by persons not handling cash and bookkeeping/Treasurer duties, adding another layer of review or approval, and rotation of duties.

2. Approval of Expenses – the Church Board should prepare an annual Budget and approve all payments over a set amount. Monthly Board meetings are a good opportunity for approving payments. If needed earlier, approval may be obtained by group email. (See “More on Controlling Expenditures” below.)
3. Background Checks - any person significantly involved in the financial process should have a background check.

CHURCH FINANCIAL BEST PRACTICES

4. Review of Bank Reconciliations and Periodic Financial Reports – Monthly Financial Statements, such as Balance Sheet, Statement of Revenue and Expense (P&L), and Budget to Actual reports should be prepared by the Church Treasurer and reviewed by the Church Board every month. Monthly reconciliations of all bank accounts should be presented to the Church Board as well.

More on Handling Cash

Controls over the handling of cash are essential. Each week, two counters should count and fill out the deposit slip and Tithe/Offering Record (which should show the total collected). Checks should be stamped with a restrictive endorsement stamp. The cash and checks and deposit slip should be sealed into an envelope for the bank. Once these are completed, the Tithe/Offering Record should be given to the Bookkeeper for entry into the books and records, and the envelope should be immediately dropped into the bank's overnight depository. If this is not possible, it should be locked in a safe place until it can be brought to the bank. The bank should be instructed to mail a receipt for the deposit to the church's mailing address on record. Once the receipt arrives in the mail, the bookkeeper can staple it to the Tithe/Offering Record for the week.

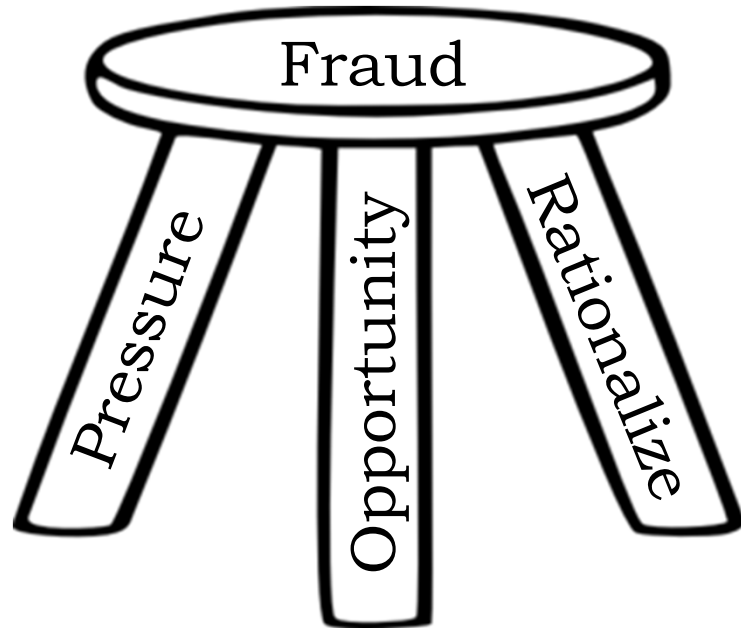
The above process will ensure that the funds expected to be deposited into the bank account, actually were deposited into the bank account. Any discrepancies should be immediately investigated. Every week, the Bookkeeper should check that the receipt from the bank, for the correct amount of the deposit, arrived in the mail.

More on Controlling Expenditures

If the church uses credit or debit cards for certain expenditures, policies should be written about their use. Use of credit and debit cards should be monitored, strict limits applied, and every use should be backed up with a detailed receipt for the purchase. If available, receipts for online purchases for which a credit or debit card was used should be emailed to the bookkeeper immediately.

Special attention should be paid to checks written payable to the Treasurer, bookkeeper, Pastor (other than regular paycheck), or Board member. Reimbursements for approved expenditures should be documented with receipts attached.

The 3 Legged Fraud Stool.
Each of the legs is required to support the fraud.



Pressure Examples:

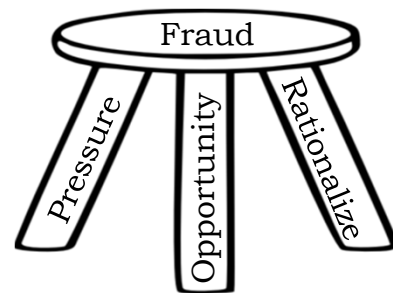
- 1) Addictions – gambling, drugs, shopping
- 2) Medical Bills
- 3) Lifestyle – keeping up with the Joneses
- 4) Financial Strain of any kind

Opportunity Examples:

- 1) Poor segregation of duties, e.g. one person makes out the deposit slip and takes the deposit to the bank
- 2) Poor oversight, e.g. no independent review of bank reconciliations

Rationalization Examples:

- 1) “I’ll pay it back”
- 2) “I deserve it”
- 3) “I need it”
- 4) “The church has plenty in the bank”



Fraud Prevention and Detection Controls

Pressure Controls:

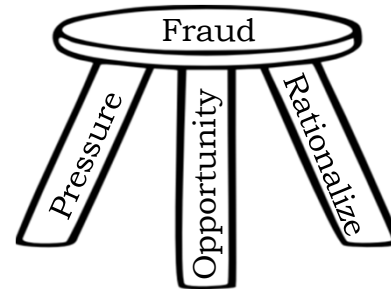
- 1) Awareness of need – medical bills, signs of addiction, financial stress, divorce
- 2) Awareness of lifestyle – fancy new car, spending beyond perceived means
- 3) Financial capacity – are they being paid a living wage

Opportunity Controls:

- 1) Proper segregation of duties
- 2) Proper oversight and review
- 3) Red Flag: Unwillingness to share duties

Rationalization Controls:

- 1) Observe attitudes, do they feel mistreated or underappreciated in their role
- 2) Be alert for 'red flag' comments – e.g. "The church has more money than it needs"



See the Church Financial Best Practices handout for more information on controls

Q: Can your most trusted employee, volunteer, treasurer, board member or pastor commit fraud?

A: Yes, trust level is often what enables (opportunity) an individual to commit a fraud. Remember with the right Pressure (sick child), Opportunity (loose controls) and Rationalization (its for my child) anyone is susceptible to committing fraud.

Good controls protect everyone:

- The church from financial loss and reputation damage
- The money handlers and accountants from false accusations or temptations

Fraud Facts

- The median fraud loss is \$130,000, the median loss is higher for small companies with <100 employees at \$200,000
- A majority of fraud victims recover nothing
- 2017 recorded **60 reported cases of fraud in the religious services industry** with a median loss of \$90,000
- 87% of fraudsters are first time offenders with clean employment histories, only 4% had a prior conviction
- 85% of fraudsters displayed at least one behavior red flag (pressure and rationalization legs)
- Internal control weaknesses were responsible for **nearly one half** of frauds (opportunity leg)
- Fraudsters with over 5 years of tenure stole twice as much as those with less tenure
- Fraud is committed by males 58% and females 42% of the time
- Fraudsters committing the biggest fraud losses were aged 56-60
- External **audits only catch 4% of frauds** – 7% of frauds are caught by accident – **internal controls are you best defense**

Source: Association of Certified Fraud Examiners

Top 8 Concealment Methods

- 55% fraudulent physical documents (checks)
- 48% altered physical documents (bank statements)
- 42% fraudulent accounting system transaction (fake deposits)
- 34% altered accounting system transactions (changed payee)
- 31% altered electronic files or documents
- 30% destroyed physical documents (bank statements)
- 29% fraudulent electronic files or documents
- 27% fraudulent journal entries (adjustment to offset theft)

Source: Association of Certified Fraud Examiners

GUIDELINES FOR THE CHURCH INTERNAL AUDIT COMMITTEE

As per the Church of the Nazarene Manual, each local church is to conduct an internal audit of its financial records annually. Usually, internal audits are performed by church members or persons closely associated with the local church. The following Guidelines are recommended as a tool or checklist when conducting an internal audit of the local church.

NOTE: As you proceed through the audit, be conscious of ways to improve the process for a safer, more secure financial system. (Think internal controls. See Church Financial Best Practices.) Written policies and procedures should be prepared by the church and, if available, these should be obtained and checked to see if they are still appropriate and if they are being followed.

1. FINANCIAL STATEMENTS/REPORTS

- a. Are monthly financial statements prepared timely and submitted to the church board?
- b. Do the statements include all funds (unrestricted, temporarily restricted and permanently restricted)?
- c. Do the financial statements include a balance sheet and statement of revenue and expense (profit & loss)?
- d. Are account balances in the financial records (i.e., bookkeeping system) reconciled with amounts presented in the financial reports?
- e. Do the reports include both monthly and year-to-date totals; budget/actual information?
- f. Do the reports make sense, or is the Treasurer the only one who understands them?
- g. **DO:** trace a sample of disbursements from the bookkeeping records to the expenditure lines in that month's financial report.
- h. **DO:** trace a month's collections and deposits to the report.

2. CASH RECEIPTS

- a. General:
 - Are cash handling procedures in writing?
 - Has the bank been notified to never cash checks payable to the church?
 - Are Sunday school offerings properly recorded and delivered to the money counters?
 - Are procedures in place to take care of offerings and funds delivered or mailed to the church between Sundays?
- b. Offering Counting:
 - Are at least two people present when offerings are counted? (These should not include the Pastor or the Treasurer.)
 - Do money counters verify that the contents of the offering envelopes are identical to the amounts written on the outside of the envelopes?
 - Are all checks stamped with a restrictive endorsement stamp immediately after the offering envelope contents are verified?

GUIDELINES FOR THE CHURCH INTERNAL AUDIT COMMITTEE

- Are money counters rotated so the same people are not handling funds each week?
 - Are donor-restricted funds properly identified during the process of counting offerings?
 - c. Depositing of Funds:
 - Are two members of the offering counting team in custody of the offering until it is deposited in the bank, placed in a night depository, or the church's safe?
 - Are all funds promptly deposited?
 - Are all receipts deposited intact? Receipts should not be used to pay cash expenses.
 - **DO:** Trace the receipt of offerings through the collection and recording process to the bank deposit.
 - d. Restricted Funds:
 - Are donations for restricted purposes properly recorded in the accounting records?
 - Are restricted funds held for the intended purpose(s) and not spent on operating needs?
3. DONATION RECORDS/ACKNOWLEDGMENTS
- a. Are individual donor records kept as a basis to provide donor acknowledgments for all single contributions of \$250 or more?
 - b. If no goods or services were provided (other than intangible religious benefits) in exchange for a gift, does the acknowledgment include a statement to this effect?
 - c. If goods or services (other than intangible religious benefits) were provided in exchange for a gift, does the acknowledgment provide information about the estimated value of the good or service received, and inform the donor that the only portion of the gift that is deductible is the amount over the estimated value of the good or service received?
 - d. Has the church adopted a policy of issuing annual contribution reports to donors listing each individual donation?
 - e. Is there any history of problems with these contribution reports?
 - f. Are the church's standards for confidentiality enforced?
4. CASH DISBURSEMENTS & ACCOUNTS PAYABLE
- a. Are all disbursements paid by check except for minor expenditures paid through the petty cash fund, (if used)?
 - b. If a petty cash fund is used, is the fund periodically reconciled and replenished based on proper documentation of the expenses paid?
 - c. If a petty cash fund is used, are vouchers prepared for each disbursement from the fund?

GUIDELINES FOR THE CHURCH INTERNAL AUDIT COMMITTEE

- d. If online Bill-Pay is used, is detailed documentation of the expense printed and filed with the other paid bills?
 - e. Is written documentation available to support all disbursements? Are dates paid and check numbers or other method of payment noted on the invoices?
 - f. Are pre-numbered checks used? **DO**: Account for all the check numbers including voided checks.
 - g. Are blank checks ever signed in advance? This should never be done.
 - h. Who has signature authority for the accounts? Is the list current?
 - i. **DO**: Trace a sample of payments from the bookkeeping reports (check register or P&L statement) to the filed documents which support them.
 - j. Is a schedule of unpaid invoices, including name, amount, due date, prepared each month for the Board's review?
 - k. Are any of the accounts payable significantly past-due?
 - l. Are there any disputes with the vendors over amounts due?
5. BANK STATEMENT RECONCILIATION
- a. Are written/printed bank reconciliations prepared monthly?
 - b. **DO**: Inspect the year-end reconciliation for every account. Trace transactions between the bank and the books for completeness and timeliness.
 - c. Are there any checks that have been outstanding over three months?
 - d. **DO**: Obtain the bank statements for the first month of the fiscal year, unopened. Are there any unusual transactions in the bank statements?
6. SAVINGS AND INVESTMENT ACCOUNTS
- a. Are all savings and investment accounts recorded in the financial records? **DO**: Compare monthly statements to the books.
 - b. Are earnings and losses from savings and investment accounts recorded in the books?
7. LAND, BUILDINGS, AND EQUIPMENT RECORDS
- a. Are there detailed records of land, buildings, and equipment including date acquired, description, and cost or fair market value at date of acquisition?
 - b. Was an equipment physical inventory taken at year-end?
 - c. Have the property records been reconciled to the insurance coverages?
8. INSURANCE POLICIES
- a. Is there a schedule of insurance coverage in force? **DO**: Take a look at insurance policies for effective and expiration dates, kind and class of coverage, maximum amounts of each coverage, premiums and terms of payment.
 - b. Is Workers' Compensation insurance being carried? Are all employees covered?
9. DEBT
- a. Is there a schedule of debt such as mortgages and notes?
 - b. Have the balances owed to all lenders been confirmed in writing and have they been compared to the obligations recorded on the balance sheet?

GUIDELINES FOR THE CHURCH INTERNAL AUDIT COMMITTEE

10. SECURITIES AND OTHER NEGOTIABLE INSTRUMENTS

- a. Does the church own any marketable securities or bonds? If so, are they kept in a safety deposit box, and are two signatures (excluding the pastor) required for access?
- b. Have the contents of the safety deposit box, if any, been examined and recorded in a file kept in the church office?

11. EMPLOYEE MATTERS

- a. Does the church maintain proper employee files, and include in each such documents as Applications for Employment, Personal Information, Performance Reviews and Evaluations, I-9 and W-4, etc.?
- b. Does the church file required federal and state payroll reports, such as Form 941 and W-2, on a timely basis?

CONCLUSION OF THE AUDIT

When the internal audit is completed, a written report should be prepared and presented to the church board. The report should include suggestions for improvements. Follow-up to insure corrective actions are taken in areas of concern. Avoid the temptation to just “rubber stamp” what has been done in the past.

(These guidelines are a compilation of suggested audit procedures from Dan Busby, CPA (specifically from Pension and Benefits USA, Memo #8), Ben Neumayer, CPA (Guidelines for Church Audit Committee), and Susan Crum, CPA, who compiled and adapted them)