

Guidelines for Committee Audit of 2007 Financial Statements

Purpose: These audit guidelines have been developed to assist audit committees in performing the annual audit of the accounting records of the parishes of the Episcopal Church.

Reasons for an Audit: Annual audits are required for all parishes, missions, and other institutions by the Canons of the Episcopal Church. Any persons handling any monies or investments of the church needs an audit to protect the church's assets and officers against suspicion of mishandling the monies and investments. Similarly, vicars, vestries, Bishop's committees, treasurers and other persons in positions of responsibility are liable for any losses which would have been discovered by an ordinary audit but were not discovered because they failed to have an audit conducted.

These Audit Guidelines have been specially prepared for Audit Committees. The Auditor's Opinion Letter issued by an Audit Committee will be termed "Committee Audit Certificate." The auditor's comments on internal control will be termed "Committee Audit Findings on Policies and Procedures."

Scope of the Committee Audit: the scope of the audit shall include:

- a. The minimum tests and checks required by generally accepted auditing standards to assure compliance with these guidelines and adequate control of the assets of each congregation;
- b. Verification of (or preparation of) financial statements in the form approved for the Episcopal Church as set forth in the *Manuel for Business Methods in Church Affairs* issued by National Church;
- c. A review of management control practices using an Internal Control Questionnaire.

Accounts to be audited: *All accounts must be audited.* This requirement covers not only the operating accounts of the organization, but also all its restricted, endowments, discretionary and property funds, and the accounts, if any, of its organizations. No church money is exempt from the audit requirements. If a separate auditor has audited a separate treasurer's account, such as that of a parish foundation, include the audit report in the consolidated financial statements.

Objectives of the Audit: The major objectives of an audit of a parish are to ascertain the following:

- a. That the various transactions during the year are proper and are documented appropriately; i.e. authorized, complete and accurate;
- b. That the various transactions during the year are recorded in the proper amounts and in the proper accounts;
- c. That the assets, liabilities, income and expenses which should be in the financial records are so shown, in the proper amounts, and in the proper accounts;
- d. That, to the extent feasible, adequate internal control procedures were and continue to be in effect;
- e. That the financial statements for the year were prepared from the financial records and present fairly the financial position of the church.

Timing of Audit: The Canons call for a church's financial year to end on December 31. The auditor should be engaged prior to the end of the period being examined. This timing allows the auditor to perform certain procedures that can only be done at year-end.

Contents of the Audit: The auditor is responsible for submitting an audit report to the Vestry of the church. The Audit report consists of:

- a. The Audit Committee Certificate;
- b. The Statement of Financial Position (Assets and Liabilities and Net Assets) presented in a columnar Fund Accounting Form (Operating, Property, Parish Organizations, Temporary and Restricted Endowment). Investments should be presented at market value as of the year-end date.
- c. The Statement of Revenues and Expenses (The overall method of accounting should be identified as cash, modified accrual or accrual).
- d. Notes should include the following:
 - i. Statement of Basis for record keeping: Cash, Accrual, or Modified Accrual. Identify any exceptions.
 - ii. Statement identifying source of any receipts from outside the control of the vestry, including trusts, foundations (parish related or other), and from the diocese. If funds have been transferred to or from an endowment or other donor restricted accounts, include details of restrictions or board designations that permit this use.
- e. List:

<u>Source</u>	<u>Amount received or accrued in 2007</u>	<u>Conditions for use</u>
- f. The completed Audit Program Checklist.
- g. The Committee Audit Findings on Policies and Procedures.

Filing of the Audit:

- a. Prior to actual delivery of the audit report, the church should issue a letter to the auditor stating that all records were made available for audit and that no church funds were omitted.
- b. Upon completion, the audit committee should review the audit report, simultaneously with the church Treasurer, Vicar, and Wardens.
- c. Any recommendations should be presented in the Committee Audit Findings on Policies and Procedures, not in the Audit Committee Certificate. These items will be discussed with the Treasurer, or other responsible persons. Their written response should be received within 30 days and be attached to the audit report for presentation to the Vestry. The audit report shall be submitted to the Vestry upon completion.
- d. A copy of the audit report shall be forwarded no later than September 1 to the Board of Missions. The minutes of the Vestry will officially record the receipt, acceptance, and subsequent filing of the audit report with this Ecclesiastical Authority.
- e. For separately incorporated institutions with fiscal years ending at other times during the calendar year, the audit report shall be forwarded to the Board of Missions no later than eight months after the end of the institution’s fiscal year.
- f. If at any time during the audit the records reveal a situation suggesting that something is seriously wrong, the matter should be brought immediately to the attention of the Vicar or Priest-in-Charge, the Wardens and the appropriate diocesan authority.

Instructions for Completing a Committee Audit

- 1. General: The following suggested procedures are merely acts that can be used to determine the appropriateness of the financial statements presented. An audit is a series of procedures to test on a predetermined selective basis the various transactions occurring in the year under examination. It is unrealistic to examine every transaction for the year. Therefore, certain test are necessary to verify the reasonableness of all transactions.

2. Pre-Audit needs
 - a. Obtain a preliminary understanding of the accounting systems, both manual and computer, that generate significant financial statement items and related principal internal accounting control.
 - b. Obtain copies of the minutes of the Vestry meeting for the period under examination. This should include the minutes of any committee authorized to receive and disburse monies. Read the minutes with regard to the election of officers, compensation of personnel, bonding of the treasurer, budget approvals, contracts entered into, purchase of items, borrowing of monies, purchase and sale of securities, resolution confirming clergy housing allowance for tax purposes, etc. This should be done before the actual examination of any accounting records. You may need to see the minutes of the previous year if they contain authorizations for expenditures in the year being audited.
 - c. Obtain a copy of the previous audit complete with the Committee Audit Findings on Policies and Procedures. This will provide you with a firm set of starting balances that may differ from the Treasurer's reports. It will also give you a chance to check on the progress of corrections of management control deficiencies, which is an important part of the teaching process.
 - d. Obtain a copy of the annual financial statements as prepared and presented by the treasurer.
 - e. Review the procedures that are being used to account for church monies. Identify the individuals with responsibility for financial operations and decisions by name and position and verify with them that all the funds of the church have been included in the statements.
 - f. Identify all bank accounts and authorized check and withdrawal signers, including those under separate treasurers.
 - g. Request that all accounting records of all funds be presented together including:
 1. Chart of Accounts and Organization Chart
 2. General Ledger
 3. Cash Receipts Journals
 4. Cash Disbursement Journals
 5. Bank Statements including cancelled checks
 6. Blank check, both in and out of binder
 7. Paid Invoices
 8. Individual Payroll Records including Forms W-4 and I-9 & 1099
 9. Federal, state, and local payroll withholding and worker's compensation reports
 10. Passbooks and evidence of other investments
 11. Pledge Records by individual and total
 - h. Meet with members of the Finance Committee to discuss the annual financial statements. Inquire if there are any significant matters about which the Audit Committee should be informed. Also, inquire into significant variances noted on the financial statements.
 - i. Request a location where the audit can be performed. The audit can be more thoroughly and efficiently performed if it is conducted in the church office where the records are located.
3. Receipts:
 - a. *Plate offerings*: Cash receipts journal entries should be traced to weekly cash receipts records (deposit slips) on a test basis. A valid test is 10% of the total number of entries. Complete *Cash Receipts Worksheet*.

- b. *Pledge receipts*: Ten percent of the pledge receipts should be verified by tracing cash receipts entries to individuals' pledge records on a test basis. A test of 10% of postings should be traced. Results will indicate if a broader sample is necessary.

Adding machine tapes should be made of the individual pledge records with the total agreeing with the total pledge payments reported.

A random selection of 10% of the total of individual pledge records should be tested for accurate total and balance.

If the auditor is engaged before year-end and if the church send statements to the pledgors, the auditor can save time and effort by supervising the mailing of the year-end statements. The auditor can then use this mailing to compare to records.

The auditors should always review the pledge receipts of the congregation personnel involved in money transactions.

- c. *Contributions from parish organizations*: Receipts must be listed separately for each organization. A sample of 10% of the amounts entered in the cash receipts journal should be traced to the weekly cash receipts records. These listed amounts should also be confirmed with their sources.
- d. *Contributions from the Diocese*: Receipts must be listed and amounts entered in the cash receipts journal traced to weekly cash receipts records.
- e. *Investments and endowment income*: Income from securities should be verified by examining the brokerage house statements. Income from investments accounts should be verified by examining the statements provided or confirmed with the trustee of the agency. Income from saving bank deposits should be confirmed by the bank. The use of a spending rule should be authorized in vestry minutes and confirmed by examining these minutes. The annual total should be checked by recalculation.
- f. *Restricted income*: Income received for special purposes should be noted by the Audit Committee and traced from the cash receipts journal entries to the weekly cash receipts records. The Audit Committee should also be satisfied that the income was used for the intended purposes.
- g. *Non-income receipts*: Verify all cash receipts journal entries by tracing them and ascertaining that the proper authorization was given for any transfer, inter-fund borrowing, or for sale or redemption of any investment or property.
- h. *Petty cash*: The Audit Committee should be satisfied that a proper imprest system is being maintained. Petty cash should not be used to cash personal checks. Cash flow and size of fund should be reviewed for possible misuse. Petty cash should be counted and recorded.
- i. All receipts should be compared to budgeted amounts and material variances should be explained.
- j. Contributions of tangible assets or services: Refer to Chapter IV of the *Manual of Business Methods in Church Affairs* (Bookkeeping) for discussion and proper treatment of these contributions.
- k. Foot the cash receipts records for two or three months. Check postings of the monthly totals to the general ledger and to the monthly financial statements.

4. Disbursements:

- a. Test 10% of postings of disbursements throughout the year to satisfy that they have been accurately classified, and that invoices in support of the disbursements have been properly

approved and canceled or marked "PAID." Complete *Cash Disbursements Test* worksheet for the sample.

- b. The committee must be familiar with the financial statement expenditure categories listed on the church's chart of accounts.
- c. All disbursements, by line item, should be compared to budgeted amounts. Any material variances should be discussed with the treasurer and explained.
- d. All pension contributions for the clergy and lay employees should be traced to the employee's elections and/or the minutes. Verify that the payments were made to the trustee or custodian on a timely basis.
- e. Testing of Disbursements: Select a sample of 10% of disbursements. Results will indicate if a broader sampling is necessary. Test the disbursements and the corresponding invoices as follows:

For the same disbursements examined under step a:

- i. Examine invoices for verification signature that the items were received or services performed for a sufficient number of items so the committee may be satisfied that goods and services were acknowledged by a person authorized to do so.
- ii. Check the arithmetic on invoices and vendors' monthly statements for a sufficient number of items to assure the committee that invoiced amounts were properly recorded on the statements.
- iii. Compare the invoices with the recordings in the cash disbursements journal to assure the committee that they are fairly recorded and classified. Comparison should include vendor's name, date and amount billed. If ten or fewer checks are written each month, examine all items. If more than ten checks are written, select a random sampling of at least 10% per month or 10 per depending, depending upon which is greater. This sample size should suffice if a good system of accounting is present. Additional items should be selected if controls are inadequate.
- iv. Travel and business expense reimbursements should be checked to see that they are in accordance with the qualified reimbursement policy of the parish. Refer to Chapter V (Taxes) for discussion of a qualified reimbursement policy.
- f. Foot the cash disbursements records for two or three months. Trace postings of monthly totals to the general ledger or to the monthly financial statements.

5. Bank Accounts:

- a. The committee should ascertain the number of bank accounts maintained and the purpose of each account.
- b. The committee should examine the canceled checks for:
 - i. Authorized signatures
 - ii. Proper endorsement
 - iii. Comparison with the cash disbursements journal for proper recording of payee and amount.
- c. The Audit Committee should account for all voided checks.
- d. Outstanding checks from the previous period should be examined to determine if amounts cleared the bank. Any check outstanding for a period longer than three months from the balance sheet date should be questioned, a satisfactory explanation obtained and voided.

- e. The Audit Committee should verify bank balances as of the end of the period being audited and should check to see that the closing cash amount is correctly stated. Examine the January bank statement following the close of the audit year for items impacting the audit year.
- f. Determine whether transfer of funds occurred between bank accounts near the balance sheet date. If transfers occurred, determine that the transfers were recorded in the books in the same accounting period and that any transfer not recorded by the bank appears in the appropriate bank reconciliation.

6. Investments:

- a. Obtain or prepare a listing of securities owned showing:
 - i. The description of each security
 - ii. The serial number of bonds or securities
 - iii. The denomination of each security or its par value.
 - iv. The interest rate of each bond
 - v. The cost of each security and the amount recorded on the books
 - vi. The interest and dividends received during the year
 - vii. The market value of each bond or security as of the year-end date.
- b. Review the investment summary for reasonableness, consistency of amounts between years and obvious omissions.
- c. Compare the securities listed with ledger accounts and/or with the statement, Whenever practicable, serial numbers should be compared with records of security purchases or gifts in order to obtain positive identification and verify that substitution did not occur.
- d. Examine securities listed or obtain confirmation from the holders for securities held by depositories. Preferably, this perusal should occur as close to the examination date as possible. Insure that the securities are registered in the name of the church or are endorsed as transferable to the church. Examine the coupons on bonds to ascertain that unmatured coupons are intact.
- e. Examine all transactions for verification of acquisitions and dispositions.
- f. Trace acquisitions to disbursements records and sales (dispositions) to receipts records.
- g. Examine broker statements and compare with the investment ledger, where applicable.
- h. The Audit Committee should be satisfied that the securities are being adequately safeguarded.
- i. Examine securities for ownership, certificate number, dates, endorsements, assignments, etc.
- j. Verify any income that has not yet been distributed.
- k. Determine, by reference to the dates of purchase and disposal of investments, interest rates and published dividend records, whether income earned and accrued income receivable have been appropriately recorded.

7. Restricted funds:

- a. Obtain a list of restricted funds showing:
 - i. The source and date
 - ii. Terms governing the use of principal and income
 - iii. The frequency for distribution of activity and valuation reports and the name of persons to receive these reports
 - iv. How the funds are to be invested
- b. Examine the trust or agency agreement or donor letter for each new gift and contribution received during the fiscal year.

8. Loans:
 - a. Obtain a schedule of all loans, which includes:
 - i. Name of the lending institution
 - ii. Date of origin
 - iii. Original amount of loan
 - iv. Interest rate and payment schedule
 - v. Monthly payment
 - vi. Unpaid balance
 - vii. Purpose of loan
 - viii. Authorizing body
 - ix. Collateral loan
 - x. Restrictions imposed by lender, if any
 - b. Review loan balances for reasonableness, consistency of amounts between years and obvious omissions.
 - c. Determine that any loans for the year being examined were properly authorized and recorded in the minutes of the Vestry.
 - d. Verify by direct communication with the lender the outstanding indebtedness at year-end and its terms.
 - e. Reconcile the unpaid balance of all loans as reported by the parish records to the figure reported by the lending institution.
 - f. Verify interest paid using calculation or amortization schedule.

9. Property and Equipment:
 - a. Obtain a list of fixed assets of significant amounts showing the cost and date of purchase, if known.
 - b. Review balances for reasonableness, consistency of amounts between years, and obvious omissions.
 - c. Examine all the deeds and titles of ownership related to the properties owned by the congregation. Verify the proper recording of the name of the owner and the existence of any encumbrances or liens.
 - d. Determine if any inventory identification procedure is in effect.
 - e. The church must have a physical inventory of capital assets. The committee should test a sample of this inventory.
 - f. Ensure that all property and equipment is adequately insured.
 - g. If depreciation of property is recognized, review entries for accuracy.

10. Payroll Records (for 10% during the year, randomly selected):
 - a. Examine the individual earnings records for name, address, social security number, number of exemptions, rate of pay, and its effective date.
 - b. Ensure that the salary paid is authorized by comparing it with the amount budgeted.
 - c. Trace the individual's earnings record postings to the check register. Complete the worksheet checking the calculation of payroll taxes.
 - d. Reconcile total wages paid and total withholding taxes with the quarterly Forms 941 and end-of-year Form W-3, verifying that they were remitted on time.

- e. Determine if a current signed Federal Form W-4 and a Form I-9 “Immigration and Naturalization Service,” which is required for employees hired after November 6, 1986, is on file for each employee.
 - f. Determine if Form W-2 has been given to each employee, including clergy, and that the W-2 forms are correct and timely filed.
 - g. Determine if Forms 1099 are being provided for all individuals who are not employees and unincorporated entities paid \$600 or more annually and all recipients of educational scholarship funds of \$600 or more in a given year.
 - h. Test the payroll to be sure that a real employee exists for every payroll check written.
11. Receivables and Payables (n/a if the financial statements are prepared on the cash basis):
- a. Obtain a schedule of accounts receivable as of the balance sheet date. These may include pledge payments that were received after the end of the year in which the money was pledged or authentic obligations owed by the congregation at year-end.
 - b. Obtain a schedule of accounts payable as of the balance sheet date. These may include monies owed by the congregation to vendors at year-end for goods and services received during the year being audited.
 - c. Trace significant receivables to current year cash receipts records and/or significant payables to current year cash disbursements records to verify subsequent receipt/payment.
 - d. Discuss any old or disputed payables or receivables with the treasurer, and void.
12. Insurance: The committee should review a schedule listing the name of carrier, description of coverage period of insurance, premium amount and date of premium payment for the following policies, and check any disbursements:
- a. Fire insurance on building and equipment
 - b. General Liability (Public Liability and Property Damage)
 - c. Burglary
 - d. Fine Arts
 - e. Malpractice
 - f. Workman’s Compensation
 - g. Fidelity Bond
 - h. Automobile coverage on cars owned by the church
 - i. Non-ownership liability insurance for cars owned by others when used for parish business
 - j. Director’s and Officer’s Liability
 - k. Umbrella Liability
 - l. Other special policies held by the church
13. Discretionary Fund: Check that the discretionary fund is in the name of the parish, that the parish’s Federal tax identification number is the number used to identify the account at the bank, and that the fund has not been used for operating fund expenses or for the personal expenses of the clergy. If a separate checking account has been authorized, all monies for the discretionary fund must pass through the parish’s general bank account and a check then written to transfer the monies to the separate discretionary fund checking account.