



EPISCOPAL DIOCESE
OF WASHINGTON

*Business Methods
Workshop*

Business Methods

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Internal Controls

Purpose of an Internal Controls System

WHAT?

- ◆ Policies and procedures of the accounting system

WHY?

- ◆ Assures that transactions are recorded properly
 - ◆ Reliable records
 - ◆ Protection of church assets
 - ◆ Compliance with civil laws, church canons, organizational policies
- ◆ Reduce financial risk to a tolerable level
 - ◆ Prevent or identify inadvertent errors
 - ◆ Prevent or identify deliberate misuse of funds

Desired Qualities of the System

In developing your internal controls system, consider:

- ♦ Accuracy
- ♦ Efficiency
- ♦ Reliability

Objectives of an Internal Control System

1. Adequately safeguard cash, property and other assets
2. Ensure appropriate documentation and approval of all financial transactions
3. Ensure funds are expended in accordance with donor requirements and limits
4. Ensure financial reporting is accurate, timely and conforms to policies



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Internal Control Concepts & Considerations

5 Components of a Financial Transaction

1. Request – request to purchase
2. Approval – authorized person approves request
3. Authorization – issuance of purchase order
4. Execution – purchasing, receiving and payment
5. Recording - accounting

No one person should handle all aspects of a single transaction.

Authority and Responsibility

- ◆ Define and communicate who has authority and responsibility to initiate and approve expenditures
 - ◆ Written notification of authority levels and limits
 - ◆ Understand required documentation for expenditures
- ◆ Authority levels for cash disbursements need to be assigned
 - ◆ Approving payment requires verification that goods or services have been received and supporting documentation is on hand
- ◆ The person who authorizes a transaction cannot be the same person who records it for accounting purposes

Handling Cash

- ◆ Cash is easy to lose track of, so controls are critical
 - ◆ Receipt
 - ◆ Maintenance
 - ◆ Disbursement
- ◆ Risks with cash
 - ◆ Loss or theft
 - ◆ Disbursement without proper documentation or authorization
 - ◆ Incorrect accounting (charging of receipts/disbursements)

Handling Cash: Reconciliation & Verification

- ◆ Physical cash reconciliation:
 - ◆ Safeguards to protect collections from theft or misplacement
 - ◆ Timely counting and depositing of collection receipts to ensure deposit equals entire amount of receipts (at least weekly)
 - ◆ At least two unrelated persons responsible for counting and depositing the collection
 - ◆ Periodic rotation of persons responsible for counting cash collections
 - ◆ All cash counts documented on a standardized form
- ◆ Independent verification of accounting for receipts, blank checks and disbursement vouchers
- ◆ Regular reconciliation and independent verification are essential

Payroll

- ◆ Major risks associated with payroll:
 - ◆ Overpayment to legitimate employees
 - ◆ Payment of fictitious persons
 - ◆ Failure to recover advances
 - ◆ Misappropriation of payroll funds
 - ◆ Under or over withholding taxes
- ◆ A major independent payroll processing company such as ADP or Paychex is recommended to simplify the process and limit liability to the church

Internal Controls Questionnaire

- ◆ Tool to identify weaknesses in current systems – a “self-audit”
 - ◆ Are accounting policies appropriately documented?
- ◆ Procedural gaps identified by the questionnaire must be strengthened
- ◆ Diocese staff are available to advise on means to strengthen procedures



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Electronic Banking

Why Electronic Banking?

- ◆ EFT – Electronic Funds Transfer
 - ◆ Receipts, disbursements, transfers, donations
- ◆ Fast, easy, efficient
- ◆ Streamlines processing, reducing cost
- ◆ Time efficiency
 - ◆ Can process from the office
 - ◆ Any time of day
 - ◆ Transactions usually visible immediately
 - ◆ More secure than cash

Electronic Banking Policies and Procedures

- ◆ Formalized controls for electronic banking are necessary:
 - ◆ What electronic banking activities will be used
 - ◆ Responsible parties: who is authorized to conduct electronic transactions
 - ◆ Initiating
 - ◆ Approving
 - ◆ Transmitting
 - ◆ Recording
 - ◆ Review and reconciliation

Segregation of Duties

- ◆ Segregation of duties is critical for electronic transactions
- ◆ Minimum of 2 people involved in each electronic transaction
- ◆ Decreases risk of wrongdoing and concealment
- ◆ Authorization and transmitting functions should be separate
- ◆ Recording function should be delegated to someone who is not involved in approval nor transmitting
- ◆ Use the same controls you would for manual transactions

Types of Electronic Transactions

◆ Electronic or Wire Transfers

- ◆ Transfers of funds
- ◆ Usually effective within minutes of transaction
- ◆ Used primarily for large-dollar transactions - cost more than other types of disbursement
- ◆ Security procedures must be in place to safeguard transactions
 - ◆ Callback provision
 - ◆ Documentation
 - ◆ Written confirmation of the transaction from the bank or trust company

◆ Electronic Check Images

- ◆ Most banks now provide electronic check images instead of cancelled paper checks



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Practical Accounting

Record Keeping

Gifts

- ♦ Temporary restrictions
 - ♦ Donor has imposed conditions for use or purpose of the money
 - ♦ Legal obligation to honor donor's restrictions
 - ♦ Record of gift must be maintained
 - ♦ Requires Vestry approval
 - ♦ Must be segregated from the operating fund in the accounting records
- ♦ Permanent restrictions (Endowment Funds)
 - ♦ Donor's conditions allow only the earnings from the gift to be expended
 - ♦ The principal may be held for a specified term, or in perpetuity

Financial Statements

3 Components of Financial Statements:

1. Statement of Financial Position

- ♦ Compares against same date of prior year
- ♦ Assets, liabilities and net assets
- ♦ Also known as a balance sheet in corporate accounting

2. Statement of Activities

- ♦ Compares budget to actual activity to date
- ♦ Year end: actual activity for current year compared with budget and actual activity for prior year

3. Statement of Cash Flows

- ♦ At minimum, prepared at year end
- ♦ Shows changes in balance sheet accounts year over year
- ♦ Analyzes operating, investing and financing activities



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Audits

Audit Requirements

- ◆ Annual audits are required by the Canons of the Episcopal Church for all parishes, missions and other institutions
- ◆ Purpose:
 - ◆ Assure that financial statements are fairly stated
 - ◆ Protect church assets
 - ◆ Protect persons handling monies or investments against suspicion of mishandling
 - ◆ Demonstrate good stewardship to congregation
- ◆ Approved Auditors – CPA is preferred

Audit Approaches

- ◆ Scope of Audit:

- ◆ Sufficient tests of transactions to assure compliance with guidelines and adequate control of the assets of the congregation
- ◆ Verification of financial statements
- ◆ Review of management control practices

- ◆ Statements to be Audited

- ◆ All accounts must be audited
 - ◆ Operating accounts
 - ◆ Restricted, endowment and property funds
 - ◆ Accounts of affiliated organizations

Audit Process

- ♦ Audit conducted for church fiscal year ending December 31
- ♦ Audit report submitted by auditor to Vestry
- ♦ Filing audit:
 - ♦ Vestry issues letter to auditor stating all records have been made available and no findings have been omitted
 - ♦ Upon completion, Audit Committee presents audit report to Treasurer, Rector and Wardens
 - ♦ Any findings and recommendations should be presented in the Audit Committee Findings on Policies and Procedures
 - ♦ Discussed with treasurer or other responsible persons
 - ♦ Within 30 days, written response attached to audit report presented to Vestry

Audit Alternatives

- ◆ In lieu of a full audit, a Financial Review can be conducted under the following circumstances:
 - ◆ History of previous satisfactory audits
 - ◆ Limited financial resources
 - ◆ Approval of the Diocesan Finance Committee
 - ◆ Audit committee members are independent of the decision making and financial record keeping functions of the congregation
- ◆ A Financial Review is less expensive than a comprehensive audit, but is also less extensive



FOR MORE INFORMATION:

<https://www.episcopalchurch.org/manual-business-methods>