

Guidance to ECO churches on the “independent financial review” Polity 1.0603(g)

As per ECO Polity:

1.0603 The Responsibilities of the Session

The session has responsibility and authority for governing the congregation and guiding its mission for Christ in the world. In the Reformed tradition the marks of the church are the proclamation of the Word, the Sacraments rightly celebrated, and the exercise of discipline. Therefore, the session shall:

(g). Arrange for an independent financial review annually, and shall publish the report to the congregation and to the presbytery.

The Synod Executive Council has received specific questions as to “what makes up an independent financial review?” To answer this question we will take the words individually and specifically define them first.

The term “independent” as per the intent of the writers of the Polity document means that the person conducting the review is not the person who kept the financial books and records of the organization. It does not mean an independent CPA firm.

The term “financial review” represents an internal process performed by one, two or more members of the organization or their designees who aren’t the staff employee or other designee actually keeping the books of the organization. An “audit” represents an extensive external process performed by a certified public accounting (CPA) firm for a fee. The two are very different.

In order to give further advice as to what a “financial review” would entail, the Synod Executive Council has recommended the following best practices when looking at the financial statements¹:

- Investigate any findings that appear to be inconsistent
- Inquire about the procedures for recording accounting transactions
- Investigate unusual or complex situations that may impact reported results
- Investigate significant transactions occurring near the end of the accounting period
- Follow up on questions that arose during previous reviews
- Inquire about material events that occurred after the date of the financial statements
- Investigate significant journal entries (multiple or large sums)
- Review communications from regulatory agencies they may have received
- Read the financial statements to see if they appear to conform with the applicable financial reporting framework
- Review the management reports of any accountants who reviewed or audited the entity's financial statements in prior periods

¹ <http://www.accountingtools.com/questions-and-answers/what-is-a-financial-statement-review.html>

There are also a number of review steps and questions that can be asked about in specific areas, such as:

- *Cash.* Are cash accounts being reconciled? Have checks written but not mailed been classified as liabilities? Is there a reconciliation of intercompany transfers? Is there a petty cash drawer in the office and who has access?
- *Receivables.* Is there an adequate allowance for doubtful accounts? Are any receivables pledged? Are there any non-current receivables?
- *Investments.* How are fair values determined for investments? How are gains and losses recorded following the disposal of an investment? How do you calculate investment income?
- *Fixed assets.* How are gains and losses on the disposal of fixed assets recorded? What are criteria for capitalizing expenditures? What **depreciation** methods are used (if any – most churches operate on a cash basis)?
- *Intangible assets.* What types of assets are recorded as intangible assets? Is **amortization** being appropriately applied? Have impairment losses been recognized?
- *Notes payable and accrued expenses.* Are there sufficient expense accruals (if any – most churches operate on a cash basis)? Are loans properly classified?
- *Long-term liabilities.* Are the terms of debt agreements properly disclosed? Is the entity in compliance with any loan **covenants**? Are loans properly classified as short-term or long-term?
- *Contingencies and commitments.* Are there guarantees to which the entity has committed itself? Are there any material contractual obligations? Are there liabilities for environmental remediation?
- *Revenue and expenses.* What is the revenue recognition policy (statements)? Are expenses recorded in the correct reporting period?

The church as a matter of safe financial practices can use the following:

CHECKLIST FOR PROTECTION OF CHURCH FINANCES ²

1. Finance Committee is organized and has designated a Treasurer and Financial Secretary.
2. The Finance Committee Chairperson, Treasurer and Financial Secretary are not the same person, nor from the same family or household.
3. The church has a budget approved by the Session.
4. Treasurer's financial report is submitted at least quarterly. Results are compared to the budget and inquiries made of variances at Finance Committee meetings.
5. All checking and savings accounts are under control of the Treasurer. Investment accounts are accounted for and activity reported monthly to the Finance Committee.
6. At least two **unrelated** people count the weekly church offerings for deposit, and prepare the deposit slip. Counting occurs in a safe location. The deposit slip and deposit are placed in a bank deposit bag and locked.
7. Deposit slip stamped by the bank is given to the Treasurer for recording and comparison to the bank statement.
8. Annually the Session approves the signatories on all church bank accounts.
9. Bank account reconciliations are performed monthly and reviewed by the Finance Committee Chairperson or designee at least quarterly. This review includes examination of copies of cancelled checks to ensure proper church purpose.
10. Quarterly, the Finance Chair asks the Treasurer at a committee meeting for documentation of timely payment of state and federal payroll taxes.
11. Annual review is completed by a qualified person **or** committee and reported to the Session and made available to the congregation and the Presbytery.
12. All financial records are retained for seven (7) years.

² <http://www.wnccadmin.org/Docs/2012-InternalControlofChurchFinancesChecklist5.pdf>