

THE EPISCOPAL DIOCESE OF MASSACHUSETTS

Diocesan Policy on Financial Audits ALTERNATIVE AUDIT PROCEDURE AS OF 07/13/2011

(For use only by congregations with Operating Expenses of less than \$200,000 per year)

An audit conducted under the Alternative Audit Procedure meets the minimum diocesan standards for a “complete” audit report **for a congregation with Operating Expenses of less than \$200,000 per year**. This audit may be done by an accountant working alone or a team of at least two persons with an accounting and/or finance background.

1. At a minimum the following would comprise the contents of a “complete” audit report under the “alternative audit procedure”:
 - A copy of the Alternative Audit Procedure Checklist, with any necessary attachments;
 - A copy of the Statement of Financial Position (the Balance Sheet);
 - A copy of the Statement of Activity (the Income & Expense Statement);
 - If significant deficiencies were found in the course of the audit and they are not addressed in the notes of the checklist above, an explanation of these deficiencies and the actions proposed to address such deficiencies should be included in an attached statement;
 - A corrected Parochial Report as a result of audit adjustments (if applicable); and
 - As an attachment – a written acknowledgement that the Vestry voted to accept the audit report at a duly called meeting of the Vestry and a written response to the notes made on the checklist above (if any).
2. Diocesan action on receipt of an Audit Report will entail the following:
 - a. Confirm that the Audit Report is “complete”, per Section 1 above.
 - b. Acknowledge receipt of the Audit Report, noting any missing information.
 - c. Determine if there are any Significant Matters as enumerated in section 3 below. If so, determine the needed next steps. If there are no such matters, the Audit Report will be placed in a file for safekeeping. A list of the filed audited reports will be maintained by the Diocese.
 - d. If staff is available, the Diocese may, but shall not be required to, review in greater detail the contents of the Audit Reports of a selected number of congregations in any given year.

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3. **Acceptance or review by the Diocese of an Audit Report is not a confirmation that it is complete or accurate or that the Diocese has reviewed or approved it in any way.** In receipting the Audit Report, the Diocese does not assume any legal liability for weaknesses in findings presented or omissions later to be found in the Audit Report, except as noted in a communication from the Warden(s) and/or Priest addressed to the Diocese which might raise the following matters:
 - a. Reference to actions or inactions that necessitate disciplinary action by the Diocese under applicable Canons of the National Church or Diocese;
 - b. Reference to actions or inactions which could lead to civil or criminal liability;
 - c. Reference to there not being an ability by the auditor to “certify” the auditor’s findings.

Except for a specific and separate communication as noted above, the Audit Report and any necessary attachments, are viewed as communications between the auditor and the Vestry and are intended for discussion between the Vestry and Auditor, not the Diocese.
4. Liability Insurance under a “Directors & Officers” policy:
 - a. The church should provide in writing proof that the church participates in the Church Insurance program and in particular has a current “Directors and Officers” (D&O) insurance policy. If the church does not have D&O coverage with Church Insurance, then the church needs to provide a certificate of insurance to the accountant or volunteer(s) that it has D&O coverage which has a broad form coverage to include the accountant under its liability coverage.
 - b. The church should provide the Diocese with an executed Referral Agreement for the activities of the volunteer(s) conducting an alternative audit (see below).
5. Any congregation that does not follow these audit guidelines as outlined above shall not be eligible for:
 - a. Financial assistance from or through the Diocese, such as grants or Stokes Fund loans; or
 - b. Other Diocesan benefits, such as approval of the appointment of a new rector.
6. **A complete copy of the Audit Report is to be filed with the Diocesan Treasurer’s Office on or before September 1 of each year covering the previous fiscal year, c/o the following address: Treasurer’s Office, EDOM, 138 Tremont Street, Boston, MA 02111.**

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REFERRAL AGREEMENT AND GENERAL RELEASE FOR A PARISH ASSIGNED AUDITOR(S)

WHEREAS, it is the Parish's decision to use the services of any volunteer(s) to serve as auditor(s); and

WHEREAS, in order for a volunteer to accept this assignment, the congregation must agree to hold harmless and release The Protestant Episcopal Diocese of Massachusetts (the "Diocese") from any and all claims arising out of the activities of the volunteer(s);

WHEREAS, the Diocese is not and shall not be responsible or liable for the activities of the volunteer(s) and does not warrant or guaranty in any way the services of the volunteer(s);

NOW THEREFORE, the congregation unconditionally releases the Diocese and its employees, agents, independent contractors, representatives, trustees, officers, directors, attorneys, and affiliates and the volunteer(s) and their successors and assigns, and anyone claiming by, through or under them from any and all causes of action or claims of any kind or nature arising out of, or relating to, the congregation's relationship with the volunteer or and any activities, services or reports provided by the volunteer(s) to the congregation.

Name of Congregation: _____

By: _____

Title: _____

Received: _____
Signature of auditor

Date

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ALTERNATIVE AUDIT PROCEDURE CHECKLIST

For use only by congregations of the Diocese of Massachusetts with Operating Expenses of less than \$200,000.

Annotated Checklist for Auditors

The pages that follow have comments, guidelines and suggestions for the questions of the Alternative Audit Procedure that has been authorized for use in this Diocese by congregations with less than \$200,000 in annual Operating Expenses. This annotated workbook is intended to help a non-accountant who is conducting the audit. The workbook may also alert an accountant who is not familiar with the Episcopal Church to certain matters pertaining only to Episcopal congregations.

Unlike an audit according to generally accepted accounting principles, this procedure provides for an independent overview of the financial and business procedures and policies of a local congregation and includes the following objectives.

- 1) **We want to be sure that there is compliance with the laws.** For example, you should make sure that all matters dealing with payroll taxes and filings are being properly done. You should make sure that all compensation paid to employees, including any bonuses or extra compensation for weddings, funerals, etc., are included in the W-2.
- 2) **We want to be sure that there is compliance with the Canons of the Episcopal Church and of the Diocese of Massachusetts.** For example, was the parochial report filed in a timely fashion, and was it completed in accordance with the instructions? Can you tie the Annual Report to the parochial report? Are all organizations' accounts included in the audit in accordance with the Canon?
- 3) **We want to be sure that the Vestry is fulfilling its fiduciary responsibilities.** For example, does the Vestry receive full financial information? Are the buildings adequately insured? Is there a budget? Are Vestry and committee minutes preserved? Does the Vestry approve major expenses and note the receipt of major gifts? Is there a full report to the Annual Meeting?
- 4) **We want to be sure that basic bookkeeping is being kept up to date and that adequate internal controls are in place.** For example, are all the bank accounts reconciled regularly? Is there proper documentation for disbursements? Are the contributions records adequate? Is investment activity properly recorded and reported on?

The auditor may certainly do more than is required by these procedures.

Following are the questions from the Audit Procedures. Notes have been added when the questions are not self-explanatory. In every case in which you cannot answer a question with an unqualified "yes," you should make an explanatory comment on the last page. In most instances when you cannot answer "yes," you will probably want to recommend to the parish leadership that changes be made so the answer next year can be affirmative.

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If you are unable to answer yes to any question below, please explain why in the comments (notes) section.

Congregation: _____

City/Town: _____

Fiscal Year: _____

GENERAL REVIEW

1. Is audit report for previous year available? Yes___ See notes___

2. Have recommendations included in previous years' audits been implemented? Yes___ See notes___

Please note on the Comments page or in a separate letter whether the congregation has taken steps to implement previous recommendations from auditors.

3. Are Vestry minutes for the year complete? Yes___ See notes___

4. If a Finance or Investment Committee is authorized to expend or invest funds, are the minutes of such committee meetings complete? Yes___ See notes___

You should ask to see all minutes from November of the year before the year being audited through the first months of the year after the year being audited. For example, the budget may have been approved in December of the previous year. The clergy person's parsonage allowance resolution should have been adopted before the beginning of the year in which it was paid.

5. Review the minutes of the Vestry and such Finance/Investment Committees.

a) Was the budget approved by the Vestry? Yes___ See notes___

b) Was the parsonage allowance voted prior to being paid? Yes___ See notes___

c) Were large or unbudgeted expenditures approved? Yes___ See notes___

d) Were large or unusual receipts noted? Could you trace to recorded receipts? Yes___ See notes___

6. Are monthly financial reports to the Vestry complete? Yes___ See notes___

7. Is balance sheet and income & expense information prepared at least annually for the Vestry and congregation? Yes___ See notes___

*Especially if the bookkeeping system is manual, it is very possible that no full balance sheet is ever prepared. However, the information a balance sheet contains should be given to the Vestry and the Annual Meeting. Assets include the total in all checking and savings accounts, the total in all CD and investment accounts, and amounts the parish is owed. Most small churches will not have capitalized the value of their land, buildings, and equipment. However, we do recommend that a value be shown for the Plant Assets and that the amount provided be the most recent insurance appraisal. Liabilities include the outstanding principal of all loans, mortgages and indebtedness and all accounts payable and payroll and sales taxes payable. **A copy of the Balance Sheet and***

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the Income & Expense Statement should be attached to the completed audit package.

8. Did you examine a copy of the financial report to the Annual Meeting? Yes___ See notes___
The report to the Annual Meeting should include a full report of all funds held in the name of the congregation. This includes funds held by all organizations, such as the Episcopal Church Women, etc.
9. Did you compare the current year income and expense report with the previous year's report and receive a reasonable explanation for any significant fluctuations from the prior year amounts or from current year budget amounts? Yes___ See notes___
10. Was the parochial report filed timely? Yes___ See notes___
11. Are insurance records and property records complete? Are coverages adequate? Yes___ See notes___
In general church buildings should be covered with replacement value insurance. There should be periodic reviews of the provisions of the coverage, and the insurance company should be notified if the use of the facilities has changed. If the congregation does not have Directors' & Officers' insurance, you may wish to suggest that they look into getting it.
12. Have you seen the Articles of Incorporation and the By-laws? Yes___ See notes___
If unincorporated, suggest the Vestry review the pros and cons.
13. Is there a space use agreement and insurance certificate for each outside organization using church facilities? Yes___ See notes___
14. Have staff and volunteers attended misconduct workshops as required? Yes___ See notes___
These workshops are provided by the Diocese and are designed for clergy and lay employees and volunteers supervising and/or working with youth.

CASH BALANCES, INVESTMENTS & INCOME

15. Have you checked to see that all operating cash accounts (including all passbook savings accounts) have been reconciled regularly throughout the year? Yes___ See notes___
*If the congregation uses Quicken or another computer application, look at the reconciliation reports that should be attached to each bank statement. You need to stress that **all** accounts in the name of the church must be examined.*
16. Review all organization cash accounts (ECW, Guilds, etc.)
- a) Have they been reconciled regularly? Yes___ See notes___
 - b) Organization accounts may not be used for general parish purposes (e.g., to receive flower donations or pay altar expenses). Are the organization accounts free of activity that should have been in the operating fund? If there was operating fund activity in these accounts, was it included in the parochial report? Yes___ See notes___
 - c) List any accounts that exist that you were **unable** to examine:

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17. Examine year-end statements of any invested funds. Are all investments properly recorded on the books? Yes___ See notes___
18. Were any restricted gifts received during the year? Yes___ See notes___
19. Has the congregation respected donor restrictions on all current and past gifts? Yes___ See notes___
20. Review procedures and control of plate collections, other cash receipts and deposits? Do these systems provide adequate controls? Yes___ See notes___

More than one person should be present when the Sunday offering is counted and deposited. If at all possible, the person who records the individual contribution records should not be the same person who reconciles the bank statement. No one should be cashing checks into the offering. The entire offering should be deposited. Cash from the offering should not be used to make reimbursements or replenish petty cash.

21. Are contribution statements sent out at least quarterly? Do the statements show the pledge balance? Yes___ See notes___

CASH DISBURSEMENTS

22. Did you receive a list of authorized signatories for each account? Yes___ See notes___
23. Examine a selection of disbursements.
- a) Are there invoices (not statements) for disbursements? Yes___ See notes___
 - a) Are there authorizations for disbursements? Yes___ See notes___
 - b) Do checks have the specified number of authorized signatures? Yes___ See notes___

*Examine the documentation supporting at least 5-10 checks drawn in each of at least two months of the year. Look at large one-time expenditures, checks made out to individuals, and some from regular vendors. There should be an invoice (not a statement of account) that describes what was purchased. If it's a bill for office or maintenance supplies, for example, there should be some indication on the invoice that the items were actually received. An extraordinary item should refer to Vestry approval. If a copy of the check is not attached to the bill, the check number and date paid should be written on the bill. Payments to individuals need to be properly documented with receipts, mileage forms, etc. **Checks should not under any circumstances be made out to Cash.** For example, checks to replenish the petty cash fund should be made out to the person who cashed it: **Mary Jones/Petty Cash.***

24. Is the accounting system used adequate and properly maintained? Yes___ See notes___

This is a wide-open question because all kinds of systems are in use. Take the opportunity to see if a computerized system is possible. For small parishes, especially if contribution records are maintained manually (preferable if there is no paid office staff), Quicken Basic may be sufficient. You may also recommend to the church that they talk with neighboring churches about their accounting system.

All financial records should be kept at the church. (We have a very few congregations where this is

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*physically impossible because there is no parish office.) In all other instances you should strongly recommend that **all** financial records (including organization accounts) be kept securely on church property.*

LIABILITIES

25. Are clergy and lay pension payments calculated correctly and up to date? Yes___ See notes___
26. Are diocesan assessment and any diocesan loans current? Yes___ See notes___
27. Are utility and insurance payments current? Yes___ See notes___
28. Are any mortgages or other loan payments current? Yes___ See notes___

Verify that the diocesan assessments and any Diocesan loans due at year end reconcile to either the year end Diocesan assessment and loan statements or Diocesan records at year end.

DISCRETIONARY FUNDS

29. Is the account in the name of the church? Was it set up by Vestry resolution?
Is the church's tax ID number used for the account? Yes___ See notes___
30. Is the discretionary account free of operating fund activity, or if there was operating fund activity in the account, was it included in the parochial report? Yes___ See notes___
31. If the account was used for personal expenses which the IRS would consider taxable, were these amounts included in the priest's W-2? Yes___ See notes___

If necessary, see the guidelines available in MANUAL OF BUSINESS METHODS IN CHURCH AFFAIRS, Chapter V.

PAYROLL

32. Are workers properly classified as either employees or independent contractors? Yes___ See notes___

*In general employees are those who work set times at the employer's location using tools and materials supplied by the employer. Independent contractors are hired to do a job, for example to write a curriculum or put on a new roof. The employer does not set their daily work schedule, and they don't use the employer's tools and materials. Independent contractors usually submit invoices for their work. Independent contractors are **never** compensated for times they do not work—an independent contractor doesn't receive vacation or sick pay. Check with the diocesan Director of Human Resources if there are questions. It is important to classify people correctly; the Social Security Administration wants the employer's share of the payroll tax to be paid. The Commonwealth also wants to know that people are properly classified as employees. The rule is that an individual is to be considered an employee and receive a W-2 unless they meet the tests to be classified as a contractor.*

33. Are 1099s issued to independent contractors who made more than \$600? Yes___ See notes___

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34. Do payroll records indicate that filing requirements were met and that withheld taxes & all employer taxes were properly calculated and remitted? Yes___ See notes___
35. Do the salaries authorized in the budget match the amounts actually paid? Was all compensation, including any bonus, reported on the W-2? Yes___ See notes___

PAROCHIAL REPORT

36. Compare the annual report to the parochial report. Are **all** amounts entered on the parochial report in accordance with the parochial report instructions? Yes___ See notes___

If needed, refer to the instructions for the financial section of the Parochial Report and to our diocesan procedures for netting the cost of providing space from the gross amounts received for space use by outside organizations. The definitions of operating and non-operating income and expenses in the Parochial Report instructions are very clear. There should be no great difficulty in tying the report received by the Vestry and the Annual Meeting to the Parochial Report.

37. If not, has a revised parochial report been prepared and submitted? Yes___ See notes___

A revised financial page of the parochial report should be filed if you discover material discrepancies between what was reported and what should have been reported. A material discrepancy may be defined as one that amounts to 5% or more of the amount reported as Normal Operating Income (line A) and Subtotal Operating Expenses (line E).

LITIGATION

38. Is there any current or threatened litigation involving the congregation? None___ See notes___

Find out about any cases where papers have actually been served and any cases that are threatened. Does the parish have appropriate legal counsel? Have there been timely communications with the insurance carrier about cases covered by liability insurance?

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COMMENTS (NOTES)

Note here or in a separate letter comments about any question above that you could not answer in the affirmative. Please number your comments to correspond to the question you are commenting on.

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RECOMMENDATIONS

Note here or in a separate letter any recommendations about needed improvements in systems or controls. Anything included here should be discussed with the congregation's leadership.

If you note things that you think should be improved, discuss them with the clergy and financial leaders before including them in this report. The recommendations you make should not reflect just your preferences, but should be items where

- 1) laws are being violated (e.g., not issuing 1099s or W-2s as required by law; failing to include taxable items purchased with discretionary funds on a W-2); or*
- 2) Church Canons are being violated (e.g., not including organization accounts and discretionary funds in the audit, improperly filling out the parochial report).*
- 3) a congregation is failing in its fiduciary responsibility (e.g., not reporting regularly to the Vestry, not having a budget, being inadequately insured); or*
- 4) basic bookkeeping matters are not attended to (e.g., bank accounts not reconciled, no documentation for checks, inadequate contributions records).*

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AUDITOR'S CERTIFICATION

I certify: (1) that I have performed the procedures outlined above; (2) that I have noted all exceptions on this form or in an attached letter; (3) that I have included all recommendations on this form or in an attached letter; (4) that I am not an officer of the congregation being audited; and (5) that I have no conflict of interest in performing the Alternative Audit Procedure for this congregation.

Date

Auditor's signature

Auditor's telephone number

Auditor's e-mail address

Submit the completed audit report, with the fiscal year balance sheet and income & expense statement and written response from the Vestry to audit comments/recommendations, to:

*Treasurer's Office
Diocese of Massachusetts
138 Tremont Street
Boston, MA 02111*

***Thanks to the Episcopal Diocese of New York, The Rev. Jerry Keucher, Controller, for permission to use this document with some revisions.*