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Church Accounting

Good Intentions and Good Accounting

By Karol Beth Prentice

Research indicates that the accounting system in a majority of churches today is inadequate. The lack of internal control and properly trained financial officers within the church contributes to this deficiency. However, a sufficient body of knowledge has not been available to the churches in a form which they can either understand or implement. As a result of these shortcomings, financial reports are being prepared and presented to church boards and congregations which cannot result in a meaningful interpretation as to what has actually occurred. Therefore, this article will examine the present status of church accounting, the proper type of accounting system, the necessary financial personnel, internal controls, methods for keeping the books, financial statements, and the yearly audit.

Present Status of Church Accounting

Today, "... the church is, in simple dollar terms, wealthy.... the church's wealth is held by countless different groups, in many different forms (property, stocks, bonds, commercial interests, for example), and under hundreds of different types of arrangements" [Powers, 1971, p. 28]. This reason alone would be suffi-

cient to strongly encourage the enactment and implementation of good accounting systems by such organizations. However, a second extremely important consideration relates to accountability. The church officers maintain a financial responsibility to the church congregation.

The problem with church accounting systems is that often these responsibilities have not been taken seriously. The Thomas Road Baptist Church of Lynchburg, Virginia evidences this fact. This church, which claims assets in an amount greater than fifteen million dollars, was charged by the Securities Exchange Commission with fraud and deceit in the sale of church bonds. In reply to this accusation, the pastor alleged inadequate bookkeeping, poor records, and rapid growth to be the causes of such problems [Ellis, 1974, p. 45]. If a church of this size and outreach is experiencing such problems, what must be happening in smaller churches where expertise is generally not available?

Because churches deal with relatively large sums of money, certain internal control procedures should be practiced. However, these sums of money are often handled in a very casual manner and the internal control process is ignored or even nonexistent. The dominant internal con-

trol problem involves control over cash receipts. Two other deficiencies in internal control relate to disbursements not properly authorized and the lack of segregation of responsibilities (receiving and depositing cash, posting to contributors' records and maintaining other accounting records).

Church members may experience difficulty in accepting an internal control system for one primary reason—they hesitate to acknowledge that wrongdoing or mismanagement could be caused by those in whom they have placed their utmost trust and confidence. Aside from the prevention of deception, there are numerous other benefits that would be realized with the installation of an adequate internal control system. Internal check provides a means of preventing and detecting error, safeguards assets from deterioration and theft, improves the reliability of accounting records, and avoids questions regarding dishonesty or mismanagement [Leathers and Sanders, 1972, p. 22]. Before any such system can become dependable, well-planned and well-developed accounting records and satisfactory segregation of duties must exist.

Various studies have been conducted by both public and private organizations in an attempt to establish guidelines for nonprofit concerns. In some industries, specific audit guides have been issued by the AICPA peculiar to their particular type of activity. Churches, whose needs, problems, and users are definitely unique, have not been considered in such studies. In 1971 the Catholic Church in the United States, with the aid of Peat, Marwick, Mitchell and Co., developed a guide to improve financial reporting entitled *Diocesan Accounting and Financial Reporting* [Robinson, 1977/p. 29]. There has been some consideration of such matters in the past, but greater strides must continue into the future.

Proper Type of Accounting System

As is true for all organizations, the first necessary step involves the establishment of goals—the identification of the church's overall purpose for existence. One author, James

Leahy [1974, p. 14], believes that such a determination hinges on first gaining a complete understanding of the community's needs. Goals can then be set which will quantifiably measure quantity and/or quality of results. Even though there exists the possibility that every church could have the same objectives and goals, time and effort should be spent in order to tailor these goals and objectives to meet the needs of each and every particular church body.

The accounting system must be designed to incorporate the goals and objectives of the church and to meet the needs of its users. The objectives of a church accounting system include the following [Woodard, 1976, p. 302]:

1. To produce complete and accurate accounting information as the basis for the handling of the financial affairs of the church in a businesslike manner.
2. To secure a sound financial foundation.
3. To keep members accurately informed on current financial matters and encourage their more active support.

Upon this foundation, a specific accounting system can be designed to meet objectives. Virtually every system should be implemented on a cash (instead of accrual) basis, should utilize a double-entry system (in contrast with a single-entry system), and should make use of simple fund accounting techniques.

Because of the many nonaccountant treasurers and financial secretaries, simplicity is the key in church accounting. Obviously, the cash basis method would be the easiest to implement. Even though this procedure may have only short-run applicability, it is still an adequate method for churches to employ. As previously mentioned, dollar accountability is the primary reporting function. The cash basis of accounting measures this area of accountability as it portrays the inflows, outflows, and balances of resources. Furthermore, there is no assurance that pledges will actually be honored or that bills will be paid if the anticipated revenues do not materialize. This problem is more critical for organizations like churches than it is for business entities. When utilizing

the cash basis of accounting, the financial statements should state this fact and avoid the use of the terms expense and expenditure. Instead, the word disbursement should be referred to and utilized on the financial statements.

The double-entry system of bookkeeping provides a measure of protection and should be supported by the adoption of other internal control procedures. This system is required in order to insure that transactions are properly reflected in the records.

Fund accounting necessitates the use of separate groups of accounts or funds, each fund being a distinct accounting and reporting entity. It utilizes a complete double-entry set of records whose accounts are self-balancing. The use of these various funds enables managers to discharge their stewardship obligations and account for the use of designated and otherwise restricted assets. Examples of funds include the following: general fund, benevolence fund, building fund, missions, and debt retirement.

Necessary Financial Personnel

In order for any accounting system to be effective—whether in profit or nonprofit organizations—there exists a need for properly trained and educated personnel. In the church environment, these needs include a treasurer, financial secretary, counting committee, budget committee, and audit committee.

The ultimate responsibility for financial matters rests with the Board of Deacons or the Board of Trustees, not with the pastor. In large churches, a church business administrator may be necessary to supervise daily financial activities.

“If the assets are to be safeguarded, if there is to be protection against improper fund disbursement, and if there is to be no unauthorized incurrence of obligations, the accounting procedures and the operations must be separated—even in churches” [Keister, 1974, p. 41]. This separation of duties is an extremely important internal control device.

The treasurer supervises the accounting function. He has the responsibility of safeguarding the financial assets. His duties include

Simplicity is the key to church accounting.

preparing the financial statements for the church board and congregation, signing all checks, completing any necessary government forms (such as required for employees) and participating as a member of the counting committee. As to the function of signing checks, it is extremely important that checks not be signed in advance in blank. Before signing the checks, the treasurer should examine the supporting documents.

Maintenance of the formal accounting records is one of the responsibilities of the financial secretary. Because of this duty, it is imperative that the financial secretary never handle cash. He/she also prepares the supporting documents for disbursements and then prepares and signs the checks before forwarding them to the treasurer.

Three members, the treasurer, a trustee, and one other church member, comprise the counting or tellers' committee. The latter two members of the committee should be rotated with other such people every several months. However, this rotation must be balanced with the aspect of confidentiality. Some church members may not be overly appreciative of general congregational knowledge as to the exact amounts of their gifts. The duties of this committee include counting the offerings, verifying the amount written on the outside of envelopes with the amount actually given, listing names and amounts from checks, completing the report for the financial secretary and making the deposit.

The budget committee unifies the budget. This responsibility does not involve the actual derivation of each individual budget, but does include

Church members tend to resist acceptance of an internal control system.

the job of preparing the budget for its various necessary approvals. This responsibility could be delegated to the treasurer.

The responsibility for the performance of the yearly audit of the church's books rests with the audit committee. Acting in this capacity, the audit committee has two choices. If the church is somewhat small, members of the committee could perform the audit themselves. In the case of large churches, the audit committee would be responsible for the selection of a CPA firm to perform the audit. Another somewhat related responsibility involves the preparation of the reports of contributions for church members. This being a means of internal control, it should be stressed that contributors should inform the audit committee when their personal records do not match their report. The bank reconciliation should also be prepared by a member of the audit committee.

It is important that the services of the most qualified people in the congregation be utilized. However, no matter how educated a person may be, some training will be necessary pointing to the importance of procedures manuals which clearly define the duties and responsibilities of each officer and how each job is to be done.

Because no accounting system is perfect fidelity bonds provide a cheap means of protection from fraud and embezzlement. A fidelity bond can serve two purposes: protection of the church and a psychological deterrent to a possible fraudulent financial officer. It is suggested that a church carry protection

equivalent to the maximum amount of money subject to loss [Keister, 1974, p. 42].

Internal Controls

The primary concerns of internal control relate to cash receipts and cash disbursements. Internal control is imperative but often is overlooked [Leathers and Sandars, 1972, p. 22]:

In a typical situation these collections are made during the service by a voluntary team of ushers, left unattended during the remainder of the service, gathered up by the treasurer or chief usher following the service, and then hidden in a 'safe' place or locked in the church safe for counting and deposit by the financial secretary on Monday morning. In other cases the treasurer may count the collection but keep no record.

As evidenced from the above situation there must be internal control over cash receipts. Money can be received by the church in two ways or at two different times: during the services and in the church office during the week. As previously mentioned, the counting committee's responsibility includes counting and depositing the money received in the services. Some type of receipts summary report should be prepared which indicates the source of receipt and its purpose. The source refers to whether the receipt was in the form of currency, bills, checks, or in an envelope with the latter two requiring itemization. The report also specifies the intended purpose of the receipt: undesignated or designated. A receipts summary report should be prepared in duplicate with one copy for the audit committee and one copy for the counting committee. Along with this report, the envelopes should be forwarded to the audit committee.

Occasionally special contributions may be received during the week. Receipts of this nature can be handled by the church secretary. A prenumbered receipt should be prepared by the secretary who then turns both items over to the counting committee for inclusion with the next offering.

The basic internal control weakness related to disbursements is lack

of proper authorization. [Larson, 1957, p. 33]. The accounting system must, therefore, provide an indication that such approval has been granted.

Very rarely do churches utilize a purchase order and purchase requisition system. Excepting very large churches, such procedures are generally not practical or necessary. However, only authorized persons should be allowed to make purchases, and then only if there is an unobligated budget balance. Purchases over a set amount, regardless of their provision in the budget, should be requested in writing for assurance of sufficient funds to cover the cost.

Because the purchaser has knowledge of the receipt, the financial secretary will require him to initial the invoice when it arrives. The invoice is next compared with its supporting documents; the check is prepared, signed by the financial secretary, and given to the treasurer for his approval. The treasurer should never—under any circumstances—sign a check which is not accompanied by supporting documents. All disbursements, except for a small petty cash fund, are to be made by check.

If a desired purchase has no provision in the budget (in excess of a certain amount), it will need to be approved by the church membership or its delegation. Smaller purchases would require only the permission of the board with still smaller, non-budgeted purchases at the discretion of the financial secretary and/or treasurer.

Methods for Keeping the Books

The system used to accumulate the data is a simple matter of preference, as long as all of the preceding requirements are met. The system needs to be as simple as possible. Consistency also plays an important role.

Because a double-entry system has been advocated, a journal becomes a necessity. "A more efficient method is to record transactions in a journal . . . and then to transfer amounts from the journal to the ledger . . ." [Ellis, 1978, p. 13]. The ledger ought to be designed to show year-to-date disbursements, budget, and unencumbered bal-

ances [Floyd, 1969, p. 57]. Extremely small churches may choose to use the checkbook itself for these purposes instead of the ledger set-up. Care should be taken to assure that the proper funds are credited and charged.

Financial Statements

There are two broad categories of church financial statements: those used primarily by church management and the general-purpose statements used by the church congregation as a whole. Therefore, statements must be designed that can effectively communicate the accounting information to the board as well as to the congregation.

Those ultimately responsible for the church's financial affairs, such as the board of deacons or trustees, should receive three statements monthly for discussion at their meetings: statement of receipts and disbursements, balance sheet, and funds statement. The first statement would be a summary of the month's transactions or activities. (See schedule 1).

A balance sheet should be presented in order to provide comparative data on a monthly basis. The need to know the financial standing of the church as a whole at a particular point in time necessitates such a presentation.

The third statement to be presented to the board monthly is the funds statement. Such a statement provides comparative data for the detailed transactions occurring within each of the individual funds. (See schedule 2)¹.

When a financial report is distributed to an average congregation, probably the most common reaction encountered from church members is 'Why do they have to make these reports so complicated?' or perhaps 'What good is a financial statement if nobody understands it?' [Crawford, 1978, p. 25]

Communication is the key to a well-prepared financial statement. An average church member will examine a financial statement to find answers to two questions: how much were cash receipts and cash disbursements, and what is the church's financial position regarding major fixed assets and liabilities.

SCHEDULE 1

Cash Basis Statement of Receipts and Disbursements (To be Presented Monthly To The Board)

Church _____
Month _____ Year _____

Fund	Beginning Balance	Receipts	Disbursements	Ending Balance
General	\$	\$	\$	\$
Building				
Debt Retirement				
Benevolence				
TOTAL	\$	\$	\$	\$

SCHEDULE 2

Cash Basis Funds Statement (To Be Presented Monthly to The Board)

Church _____
Year _____

	(Date)	(Date)
Beginning fund balance	\$	\$
Revenues—		
Plate collections		
Sunday school offerings		
Special collections		
Interest earned		
Miscellaneous		
TOTAL GROSS INCOME		
Disbursements—Operating		
Salaries		
Rent		
Utilities		
Supplies		
Telephone		
Insurance		
TOTAL OPERATING DISBURSEMENTS		
Net of operations	\$	\$
Capital disbursements		
Retirement of debt		
Transfers		
Net increase (decrease)	\$	\$
Ending fund balance	\$	\$

¹Condensed and revised from a funds statement presented by Bruce Woodard [1976, p. 315].

SCHEDULE 3

Financial Report to Congregation (To Be Presented Quarterly)

Church _____

	19X1 Actual		19X1 Budget		Budget (Over) Under	
	Qtr.	YTD	Qtr.	YTD	Qtr. %	YTD %
Undesignated Receipts						
Undesignated Disbursements:						
Salaries						
Sunday School						
Equipment						
Total Disbursements—undesignated						
Excess (deficiency) of Undesignated Receipts over Undesignated Disbursements						
Designated Receipts:						
Building Fund						
Missions						
Designated Disbursements:						
Missions						
Total excess (deficiency) of Receipts over Disbursements						
Add beginning cash balance						
Less: ending cash balance—Note A						
near future payables—Note B						
restricted balances—Note C						
Unobligated, unrestricted cash balance						

Note A — Cash balances:

General fund	\$
Building fund	\$
.....	
TOTAL	\$

Note B — Near future payables include:

Accounts payable	\$
Insurance payable	\$
.....	
TOTAL	\$

Note C — Restricted balances include:

Building fund	\$
Missions	\$
.....	
TOTAL	\$

Note D — Non-cash property holdings

Note E — Liabilities and future cash commitments

²The statement presented is a combination
of two primary sources [Ellis, 1975b, p. 41] and
[Crawford, 1978, p. 26].

Quarterly, a financial report is presented to the congregation. (See schedule 3)². The suggested approach utilizes the presentation of only one statement with additional, helpful information set out in the footnotes. It summarizes relevant information and avoids being a conglomeration of hard-to-digest data. Thus, it is readable and should be understandable by a majority of the congregation. The important aspects of this type of statement include the following:

1. Data enabling the reader to compare the present quarter with year-to-date totals.
2. Data enabling the reader to compare the actual inflows and outflows with the budgeted inflows and outflows for both the present quarter and year-to-date totals.
3. Budget variances computed on a dollar amount as well as a percentage basis for both the present quarter and year-to-date totals.
4. Undesignated receipts and disbursements segregated from designated receipts and disbursements.
5. The status of the individual funds computed and their cash balances given.
6. The bottom line figure representing the unobligated, unrestricted cash balance, as this figure cannot be as readily manipulated by a treasurer seeking to present "good" statements.
7. The balance sheet aspects of reporting are condensed into the footnotes.
8. Any other significant information that would aid in the decision-making process presented in the footnotes.

Annual reports supplied to the congregation would follow closely the format of those prepared monthly for the Board of Deacons or Trustees. At such time, a verbal explanation by the treasurer should accompany the written statements. The treasurer should also answer any questions so that the congregation as a whole sufficiently understands the statements.

In the church setting, the budget provides a means of controlling the amount of cash disbursements.

Therefore, it should be prepared with an extreme amount of care—not as in the following manner [Ellis, 1975a, p. 7]:

The chairperson begins: "The meeting will come to order. We have only one hour before Monday Night Football to approve budget requests for the coming year and to review program status reports supporting such requests."

"The chairperson of Project A requests a 10% increase over last year's budget. He failed to submit a report on goals for his project and results of last year's activities. Oh well, we know, the problem everyone is having with inflation; let's approve the request"

"Now here's a new project—funds needed to promote A. Person for mayor. This raises a question concerning the church's participation in such an activity. A. Person is a member of our church; let's approve it, even though I'm not sure this is one of the purposes of our church"

"The director of Program H says he can't submit a list of goal accomplishments because he forgot to remind the secretary to collect data each month. Nevertheless, he feels the program was worthwhile. I'm sure he knows what he's talking about"

(And so the meeting goes until members rush home to watch Monday Night Football.)

The budget should be prepared on a quasi-program basis. Some items lend themselves toward a program budget approach (Sunday School, Missions, Youth Groups) and thus should be budgeted in this manner. However, other necessary disbursements such as the pastor's salary, utilities, building and grounds expense do not. It would be impractical to group these necessary cash outlays into individual programs.

The second guideline in budget preparation involves the use of the ground level approach. As a starting place, the lower level personnel such as Sunday School teachers or choir directors should submit their proposals to the budget committee. Once all of the proposals have been received, the budget committee has the responsibility of unifying the process. After presentation to the Board for approval, all of the fine details should be ironed out and an agreement reached. The final step requires approval by the membership of the church.

Accounting statements must be designed that will communicate to both the church board and congregation.

Yearly Audit

"Because there is virtually no internal check in church accounting the audit is all the more important" [Slade, 1960, p. 153]. Regardless of the size of the church, a yearly audit is necessary. This audit is the responsibility of the audit committee and can be performed by either members of the church or an external CPA firm.

Although audits by external professional accountants provide an excellent measure of evaluation, their costs may preclude many churches from seeking the services of such individuals. The benefits derived must be weighed against the cost of such a service. The benefits of an external audit include [Holck and Holck, 1978, p. 238] —

1. A congregation can receive professional assistance in the preparation of its financial statements and reports from an outside expert.
2. Because internal controls are often lacking in a congregation's cash handling procedures, an independent auditor can make suggestions and initiate changes no member would think about or could ever achieve.
3. An opinion regarding the congregation's financial statements gains credibility when a Certified Public Accountant makes the audit.
4. Any payroll tax problems or unrelated business income reporting forms can be accurately completed by an independent auditor.

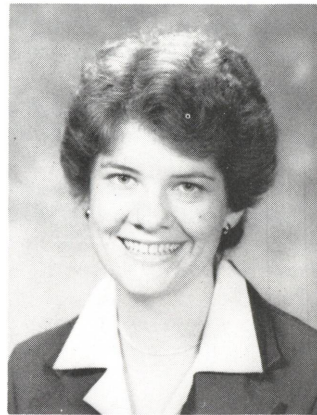
If a member or members of the church are delegated to perform the audit, care should be taken to enlist the most qualified personnel in the church to do the job. This person or persons should make every effort to conduct the audit in conformity with the generally accepted auditing standards. The overall objectives of the church to be considered are [Ellis, 1978, p. 108] —

1. To determine that adequate internal control procedures exist, and that such procedures are being followed.
2. To determine that all donations to the church were deposited and recorded correctly.
3. To determine that securities were safeguarded, and that related revenue was collected and recorded.
4. To determine that disbursements were properly authorized—i.e., that the budget was followed or that changes were approved—and that authorized members approved payment of invoices.
5. To determine that payments to vendors at year end were not delayed because of overspending the budget.
6. To determine that records were maintained on plant and equipment items, and that adequate insurance was obtained.

7. To determine compliance with federal and state regulations, including properly and timely paid employment taxes and income taxes, if applicable.
8. To recommend improved procedures and practices.

Call for Action

The problem of inadequate church accounting and reporting systems deserves and needs attention. The weaknesses found within the internal control process and within the financial statements themselves demand correction. Further studies need to be conducted with the results made available to the individual churches in a form which is understandable and applicable.



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