The Episcopal Diocese of Massachusetts

TREASURER'S HANDBOOK

Prepared by the Congregational Business Consultants

(Third Edition 2020)

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1. Basic Treasurer Responsibilities

Support

Our diocese is committed to helping treasurers in fulfilling the basic responsibilities of their office. If you would like assistance, or if you have questions, call Chris Meyer at 617-527-2739.

Legal Duties

All organizations using the church's tax id are part of the church and under the purview of the treasurer, wardens and vestry. Allowing any organization to operate independently without oversight could put the church at significant risk (e.g., loss of tax-exempt status, financial liability, lawsuits, violation of canon). These organizations all need to be included in the church's financial reporting.

The overall responsibilities of the parish treasurer stem from the Manual of Business Methods in Church Affairs (the "Manual") and from the parish bylaws. Our diocese's model bylaws set out the following duties of the treasurer:

- to receive and disburse all monies collected under the authority of the Vestry,
- to keep a true record of receipts and disbursements,
- to present a full statement of these [receipts and disbursements] and of the financial condition of the Parish [the statement of financial position] at Annual Meetings and at other times required by the Vestry, and
- to maintain the records of all trusts and permanent funds belonging to the Parish, listing the source and date of such trusts and funds, the terms governing the use of principal and income, to whom and how often accounts are to be made and how the trusts and funds are invested.

The treasurer is also responsible for:

- establishing an effective system of internal controls for his or her parish with appropriate segregation of duties to assure oversight. "No one person should handle all aspects of a single transaction," and "procedures need to be in place that ensure periodic independent reviews are performed," (See generally, Manual II-2-4) and
- assuring compliance with legal requirements with respect to employment, e.g. withholding and other taxes, I-9 forms, W-2s and 1099s.

Finance Duties

With respect to their finances, parishes are expected to comply with the requirements of the Manual, which is based partially on Generally Accepted Accounting Principles (GAAP), but with numerous modifications that take into account the realities of small and medium-sized parishes using cash basis accounting.

Banking and Other Accounts needed to Receive and Disburse Money

1. Banking accounts, credit card accounts (if any), and other accounts at financial institutions may be opened only by authorization of the vestry. Such accounts must be in the name of the parish and use its Federal Employer ID number.

2. Upon election of a new treasurer or other officer, the vestry should review the authorized signatories to the parish's checking accounts and the authority of the various officers to make withdrawals or transfers from other accounts.

3. Parishes may consider having a policy that two signatures are required for checks in excess of a specific amount, for example $1,500. Banks, in general, will not enforce two signer requirements, so compliance with this requirement must be monitored by the person performing the reviews and/or reconciliations for the specific account. Another approach is to have one person authorize disbursements of over a certain size and a different person sign the check.

4. Every parish should have an internal control system, a set of procedures (preferably in writing) that provides for the separation of duties of those who work of the parish finances, so that their work is reviewed. In particular, every parish should arrange that all monthly, quarterly, or other periodic bank and investment account statements are promptly routed, ideally unopened, for a general reasonableness review to an officer who has been independent of all the transactions in the account.

    a. For example, as to the main checking account, the reviewer looks to see -

        i. that deposits are being regularly made in reasonable amounts,

        ii. that all checks appear reasonable as to payee and amount,

        iii. that all checks requiring 2 signatures have 2 signatures, and

        iv. that all electronic fund transfers and other transactions not involving checks appear reasonable as to payee and amount.

    b. As to other accounts at financial institutions, the reviewer mainly looks to see that all funds and/or investments that should be in the accounts are in fact there, and that all transfers appear properly in both accounts involved.

    c. As to any credit card accounts, the reviewer looks for reasonableness as to payees and amounts and for compliance with parish policies.

Receipts

1. Acquire and maintain a check stamp, "For Deposit Only, Parish X" and assure that all checks received are so stamped on the date of receipt.

2. Make deposits at least once a week. Sunday receipts should generally be deposited no later than the following Monday or the first business day of the week if Monday is a holiday.

3. All receipts should be deposited first into the parish's principal checking account and then, if intended for another account, transferred to that account.

4. Quarterly pledge statements should be sent to each pledger and to each non-pledger who has made any gifts during the year.

Disbursements

1. Every disbursement must be properly authorized. It is the responsibility of the treasurer to assure that there are clear understandings with the wardens and vestry as to the authorizations required for specific types of transactions.

2. A budget approved by the vestry serves as authorization to expend funds for the purposes specified therein. Line item budget amounts should not be exceeded by any significant or unexpected amount without vestry approval.

3. The use of a payroll processor is strongly recommended.

4. There are certain payments of such importance that they should be considered mandatory except pursuant to express direction by the vestry -

    a. Payroll and payroll taxes.

    b. Medical insurance and all other types of insurance

    c. Pension

    d. Stokes loans and all other loans outstanding

    e. Utilities

    f. The Assessment, which is required to be paid monthly. (Canon 9, Sec. 3)

5. In general, all invoices and other obligations should be paid on or before the due date except pursuant to express direction by the vestry.

6. In general, all parish disbursements should be made by check from the parish's principal checking account. If amounts are being used from a fund, it is good practice first to transfer the amounts from the fund to the principal checking account and then write the check on that account.

Financial Reports

1. Financial reports should be prepared for each vestry meeting through the end of the month prior to the meeting.

2. The use of cash basis accounting is permitted by the Manual III-12 and recommended for small-to-medium sized parishes, which includes most of the parishes in our diocese. Accruals and deferrals may be used occasionally where desirable to reflect accurately the operations of the parish. This is particularly true at year-end, when, for example, all accounts payable, debts, and obligations should be accrued so that they are disclosed on the statement of financial position, and all prepaid pledges are deferred so that they are not considered income until the start of the year for which they were pledged.

3. The essential monthly report for the vestry is a Budget v Actual Report for the year to date. The vestry may request to see monthly bank balances, and periodically, say quarterly, the balances of investment accounts may be reported. The treasurer should strive to submit whatever additional reports are requested by the vestry.

4. An updated statement of financial position is sometimes not prepared until the end of the year for presentation at the Annual Meeting, although best practice is to produce these statements monthly along with statements of activities. It is desirable for the statement of financial position to include the prior year's balances for comparison. All accounts maintained under the parish's auspices should be included in the statement of financial position, e.g. thrift shop, Episcopal Church Women, rector's discretionary account, etc. Manual III-12.

5. The annual parochial report must be submitted by May 1 of the following year if submitted in digital form or by March 1 if submitted in written form.

6. An audit of the parish's books must be performed for each year. The auditor should be appointed prior to December 1 of the year to be audited, and the completed audit should be sent to our diocese by September 1 of the year following the year being audited. The audit must be performed by an independent person or persons, i.e. a person or persons who have not been involved in the parish's finances or accounting during the year. While the Treasurer cannot perform the audit, he or she is required to assist the auditor as needed.

7. The treasurer or designee is responsible for (a) producing a written response/action plan to address the auditors' findings and recommendations an (b) presenting the audit report and written response/action plan to vestry. A formal, documented vote by vestry to accept the audit and response/action plan on behalf of the congregation is required.

Funds and Fund Accounting

1. The treasurer is responsible for assuring that records are kept of the exact restriction or designation that applies to each and every fund of the parish. In the statement of financial position each fund should be correctly categorized as restricted (which can be divided into permanently restricted and temporarily restricted) or designated (unrestricted). (Manual, i-5 and III-11)

2. The treasurer is responsible for assuring that withdrawals from funds are used only in compliance with any applicable restriction or designation.

3. Unfortunately, parishes commonly lose track of the history of their funds and lose certainty as to: (a) whether particular funds are restricted or not, and, (b) if restricted, what is the exact wording of the restriction. Proper fund accounting can be complicated, and treasurers faced with uncertainty are urged to contact the Congregational Consultants at our diocese, 617-527-2739, for advice and support.

Resources

1. The requirements for parish financial matters are set out in the Manual of Business Methods in Church Affairs, which is available from the Business Practices Resources page on our diocese's web site, www.diomass.org.

2. Treasurers should familiarize themselves with the Manual Chapter II: Internal Controls, Chapter III: Bookkeeping and Chapter VI: Audit Guidelines for Congregations. Also, particularly important are the instructions for preparing page 3 of the parochial report.

3. There are also numerous other resources available to assist treasurers with respect to business practices and software on the Business Practices Resources page of the diocesan website, www.diomass.org, in the document library and in the Congregational Consultants' section.

2. Chart of Accounts

Chart of Accounts Organization

Charts of accounts vary greatly from parish to parish. The Manual of Business Methods in Church Affairs (the "Manual") provides only general guidelines. Each treasurer is responsible for establishing a chart of accounts for his or her parish that serves the parish's needs.

Financial statements are prepared principally to help the vestry manage the parish's affairs. Besides fairly presenting the parish's financial position, the financial statements have three additional important goals:

1) They should be simple enough and clear enough that they can be understood by most, if not all, vestry members, and
2) They should contain the information that the vestry needs to manage the parish's affairs without cluttering the financials with unnecessary detail, and
3) They should be set up to help in the preparation of page 3 of the annual Parochial Report.

Accounts can be numbered with most accounting software packages. This allows the accounts to be arranged in a logical order that aids in the understanding of the resulting statements. While account numbers are optional, the use of numbering is strongly recommended. For small parishes, the use of 3-digit numbers may be sufficient. The use of 4-digit account numbers is generally recommended, such as used by St. Wendy's. (See TH Forms - St. Wendy's Chart of Accounts). Very large parishes with complex accounts may choose 5-digit numbers.

Avoid a large number of small accounts in the reports. If a parish has annual operating expenses of $200,000, what benefit is gained by having accounts that routinely have less than $2,000 per year or 1% of the total? Focus attention on the big-dollar accounts and on the accounts that are likely to be discussed at vestry meetings.

An advantage of QuickBooks ("QB"), and many other programs, is that they allow for sub-accounts, and, when reports are printed, it can be decided by a single mouse click whether to print the sub-accounts or not. Here is an example of alternate presentations that are made possible by the use of sub-accounts:

5010	Clergy Salary	$72,000
5020	Clergy Add-ons	$33,200

5010	Clergy Salary			$72,000
5020	Clergy Add-ons			
	5022	Pension	$14,200	
	5024	Medical	$11,200	
	5026	Utility allow	$2,500	
	5028	Equity allow	$2,000	
	5030	Car allowance	$1,800	
	5032	Education allow	$1,000	
	5034	Travel allow	$500	
		Total Add-ons		$33,200

In general, however, the use of subaccounts is not recommended. Here, for an example, is an intermediate approach:

5010	Clergy Salary	$72,000
5020	Pension	$14,200
5030	Medical	$11,200
5040	Utility Allowance	$2,500
5090	Clergy Other	$5,300

Here is a recommended way to organize accounts, using 4-digit account numbers and different 000s for different types of accounts

- 1000s bank accounts and other assets of all types.
- 2000s A/Ps, loans, and liabilities of all types.
- 3000s restricted, designated, and all other net assets funds.

- 4000s income received in the ordinary course (operating revenue)
- 5000s recurrent and predictable expenses (operating expenses)
- 6000s all other revenue (non-operating revenue)
- 7000s all other expenses and disbursements (non-operating expenses)

The following section of the Treasurers' Handbook titled, "The Parochial Report's Relationship to the Chart of Accounts," uses this the numbering system and then maps the various accounts to the specific lines on page 3 of the Parochial Report where these numbers will appear.

The parish statement of financial position is created using the accounts numbered 1000s, 2000s, and 3000s. The statement of activities is created using the accounts numbered 4000s and 5000s (operating revenue and expenses) and 6000s and 7000s (non-operating revenue and non-operating expenses).

Properly categorizing transactions is essential to producing accurate financial statements.

1000s accounts - Assets

The 1000s accounts are for parish property of every kind - anything that can be counted or inventoried or sold. It includes all checking accounts maintained in the name of the parish or under the parish's authority (Manual III-12), for example, accounts maintained by the Episcopal Church Women, the rector's discretionary account, the thrift shop, the soup kitchen, or whatever. All the 1000s accounts will appear in the statement of financial position's assets section.

Parishes should record equipment, personal property, or capitalized expenses that exceed a dollar threshold approved by vestry as assets. (See TH - Capital Expenses and Depreciation). All parishes with respect to their equipment and personal property should obtain and save pictures, inventories (counts), appraisals, copies of invoices, etc., preferably stored off-site, as necessary to document insurance claims in the event of fire or other loss. (See TH - The Annual Inventory and Documenting Personal Property)

Real estate should be included on the statement of financial position. St. Wendy's has accounts "1810 Church (as assessed)" and "1820 Rectory (as assessed)," to disclose that it is not valuing the church and rectory at cost. (See TH - Real Estate Issues)

2000s accounts - Liabilities

Accounts payable, taxes payable, loans outstanding, obligations of every sort. A liability is an amount that the parish has a legal obligation to pay. Money received pursuant to a restriction or designation is not a liability. Money received as a prepaid pledge is not a liability.

Most parishes use cash basis of accounting, and so it is recommended that parishes not enter bills as accounts payable when they are received. Instead put bills, as received, into a "To Be

Paid" file along with requests for reimbursements, emails from priests or others requesting payments, etc. Checks are written directly against the documents in the "To Be Paid" files.

At year-end the treasurer should try to pay all bills on hand, but, if any known liabilities remain unpaid, they should be accrued so that they are disclosed on the year-end statement of financial position. The treasurer should also consider other appropriate deferrals and journal entries, so that the year-end financials accurately reflect the financial affairs of the parish.

3000s accounts - Net assets Funds

Funds reflect the history of money received and whether these monies are subject to a restriction or designation. For example, a parish's main checking account (Account 1000) may contain $20,000, and so the statement of financial position in the asset section shows, "1000. Operating Account $20,000." But where did this money come from, and what is its required or intended use? This question is answered by the 3000s funds accounts. For example (using St. Wendy's chart of accounts), the $20,000 might have 5 different sources with different implications as to how those amounts may be used:

3230.	Stokes Loan Unspent	$1,000
3245.	Stained Glass Fund	$2,000
3260.	Prepaid Pledges	$3,000
3430.	Roof Reserve	$4,000
3470.	Operating Fund	$10,000
		$20,000

Assume in December that a parishioner sent in a check for $6,500 with a note that this amount was $2,000 for his current pledge, $3,000 as prepayment on his next year's pledge, $1,000 for the music fund, and $500 for the youth program. The pledge payment is operating income, and hence must be assigned to an account numbered in the 4000s. The latter three amounts are non-operating income, and hence must be assigned to accounts numbered in the 6000s before being transferred to the proper net assets fund, numbered in the 3000s, at year end.

The proper entry (using St. Wendy's chart of accounts) when the check is deposited in the main checking account is:

Acct. #	Account	Debit	Credit
1000	Operating Account	$6,500	
4000	Pledges		$2,000
6250	Prepaid Pledges		$3,000
6300	Youth Program Fund		$500
6570	Music Fund		$1,000
			$6,500

The Manual III-11 requires that a parish's various net asset funds be divided into two categories, restricted (which can be divided into permanently restricted funds and temporarily restricted funds), and unrestricted funds, which usually have been designated by the vestry for some particular purpose. (See TH - Restrictions, Designations, and Net Asset Accounting). Thus in St. Wendy's Chart of Accounts various funds are sub-accounts of "3100. Permanently Restricted Funds," "3200. Temporarily Restricted Funds," and "3400. Unrestricted Funds."

4000s - Operating Revenue

Every dollar received by a parish during the year should be assigned either to a 4000s account as operating revenue or to a 6000s account as non-operating revenue. A common mistake is to credit non-operating revenue directly to a 3000s net assets account, which by-passes the statement of activities and renders the statement of activities and the parochial report inaccurate.

Operating revenue is new money received by the parish during the year that is regular (can be counted upon year-to-year) and predictable. It includes the various types of income that are routinely budgeted, such as:

1) pledge receipts, plate, general gifts, offerings, and collections. It also includes gifts received during the year restricted for operating purposes, such as for the flower fund.
2) money received from investments used for operations. If a parish has $100,000 invested in 3% bonds, and the income on the bonds is not subject to a restriction or designation, and the $3,000 is used for operations, then the $3,000 paid during the year is operating revenue. It is reported on line 4 of page 3 of the parochial report, withdrawal from funds used for operating purposes.
3) Instead of recognizing money received from specific unrestricted funds invested substantially in the stock market, a vestry may adopt a "total return policy." For example, St. Wendy's adopted a total return policy of 4% based upon the average of its unrestricted DIT investments over the prior 12 quarters (3 years). Thus St. Wendy's Chart of Accounts includes "Account 4340 Unrestricted Endowment 4%," and St.

Wendy's budgeted 4% x $130,000 = $5,200 as operating income. (See TH - Sustainable Use of a Parish Endowment)

4) Net, not gross, receipts for space use and fund raising. There are two ways to handle expenses for space use and for fund raising. In St. Wendy's Chart of Accounts these are assigned to accounts 5710 and 5720 at the end of the operating expense accounts. Alternatively, the expenses may be recorded as subaccounts of the related income account, e.g.:

4200	Space Use Net		4300	Fund raising Net	
	4210	Space Use Income		4310	Fund raising Income
	4220	Space Use Expense		4320	Fund raising Exp

5) Amounts received from church organizations, such as the thrift shop or the ECW (see St. Wendy's Account 4370 Thrift Shop).

6) Special gifts and bequests if they are used for operations. But gifts received - (a) that are subject to a restriction or are unrestricted, and (b) that are not used for operations during the year, should be assigned to a 6000s account (non-operating revenue), not a 4000s account (operating revenue)

Appreciation on investments is <u>not</u> operating income and is not reported on the statement of activities.

5000s - Operating Expenses

Every dollar disbursed by the parish during the year should be assigned to a 5000s account as operating expense or to a 7000s account as non-operating expense. A common mistake is to debit a disbursement directly to a 3000s net assets account, which by-passes the statement of activities and renders the statement of activities and the parochial report inaccurate.

Operating expenses are all the disbursements made by a parish during the year that are regular (can be counted upon year-to-year) and predictable. These are the expenses usually provided for in a parish's annual budget.

There are a variety of ways that parishes organize their operating expenses. No one way is required. Treasurers should try to organize expenses, using account numbers, in a way that they consider most helpful to their vestries.

Some parishes have organized their operating expenses by program categories, which is the method preferred by GAAP and the Manual. For example:

5000s	Worship	5400s	Office & Admin
5100s	Music	5500s	Buildings & Grounds
5200s	Christian Formation	5600s	Major Other
5300s	Outreach & Mission		

Many parishes have organized operating expenses by functional categories. For example, St. Wendy's uses the following categories:

5000s	Rector	5400s	Office & Admin
5100s	Other Staff.	5500s	Building & Grounds
5200s	Worship & Music	5600s	Major Other
5300s	Christian Education		

The 5600s 'Major Other' account includes the assessment, insurance, loan payments (principal and interest), and budgeted capital expenses.

Most parishes insure with Church Insurance of Vermont. The expense is categorized in "5600 Major Other" rather than "5500 Buildings + Grounds," because the standard policy includes many coverages in addition to the coverage for the church and rectory.

Capital expenses are reported on Line 15 of the parochial report, not Line 14. A parish may pay capital expenses out of operating funds, for example when it buys a computer or lawn mower or kitchen appliance. It is recommended to have a separate account, e.g. "5640 Capital Expenses paid for from operating funds" to keep track of the number that will be reported on Line 15.

If a capital expense is paid for from a fund other than the Operating Fund, then the expense is non-operating. For example, St. Wendy's has a Capital Project Fund. If money from that fund is used, then the disbursement is assigned to 7010 Capital Project Fund Disbursements. (See TH - Capital Expenses and Depreciation)

A parish is required to make the full monthly payment on its loans, and so the full amount of the monthly payment must be part of the parish operating budget. Thus St. Wendy's records the repayment of loan principal and interest in "5630 Loan Payments (P+I)," and treats both principal and interest payments as operating expenses for purposes of budgeting and reporting to the vestry during the year. But the principal and interest are reported on different lines in the parochial report and need to be broken out at the end of the year. (See TH - Loans)

6000s - Non-Operating Revenue

Non-operating revenue is basically all income that is received during the year and intended for non-operating purposes, either as an addition to funds, or to be spent during the year for non-operating purposes.

These accounts may vary significantly from parish to parish and from year to year. For example, St. Wendy's has a multi-year project to repair its stained-glass windows, and so St. Wendy's created accounts to deal with this project. Pledges were obtained at the start of the project to be paid over several years with all amounts received to be restricted to use for repair of the stained-glass windows. When a $1,000 payment is received and deposited, the entry is -

Acct. #	Account	Debit	Credit
1000.	Operating Account	$1,000	
6120.	Stained Glass Receipts		$1,000

7000s - Non-Operating Expenses

Non-operating expenses are all expenses that are not part of regular operations. They tend to be irregular and not predictable. They are usually paid for out of funds other than the Operating Fund.

For example, when St. Wendy's makes a $2,300 payment out of its Stained-Glass Fund for work that is part of its long-term stained-glass window project, the entry is -

Acct. #	Account	Debit	Credit
1000.	Operating Account	$2,300	
7120.	Stained Glass Expenses		$2,300

3. The Parochial Report's Relationship to the Chart of Accounts

The instructions for page 3 of the parochial report establish some of the basic accounting rules that parishes are required to follow, such as the definition of what constitutes an "operating" transaction and what constitutes a "non-operating" transaction.

Each treasurer should have a good understanding of how the accounts in his or her parish's chart of accounts relate to the lines on page 3, as follows:

Account Numbers	Included in Those Numbers	Parochial Report Page 3 Line #
1000s	bank accounts, investments, other current assets	19, 20
2000s	A/Ps, loans, and liabilities of all types	Not reported
3000s	All net assets funds, both restricted and designated	Not reported
4000s	Operating Revenue - income received in the ordinary course - pledges, plate, fund raisers, rent, etc., and withdrawals from funds, e.g. from the endowment, used to pay operating expenses	3 - 6
5000s	Operating Expenses - recurrent, predictable expenses	14
	• except expenses incurred to produce income (i.e. space use or fund-raising expenses, which get netted out against the income produced and reported on Line 5)	5
	• except assessment	12
	• except gifts made outside the parish, including amounts given to the rector's discretionary fund and paid for out of the budget	13
	• except capital expenses	15
	• except expenses of parish-run outreach/mission programs paid for out of the budget	16
6000s	Non-operating Income - income received for various funds or purposes other than general operations including income intended to be passed through	8 - 11
7000s	Non-operating Expenses - all other expenses and disbursements, i.e. non-recurrent or non-predictable including the paying out of non-operating income received and passed through	15 - 18

Transactions Not Reported on the Parochial Report

1. In the event of fire or water or other damage reimbursed by insurance the insurance reimbursement is not reported in the parochial report and neither are the capital expenses paid for by the reimbursement. For example, a parish suffers fire damage. It receives a $35,000 insurance payment. It pays $50,000 to repair all the damage. It conducts a campaign to raise the other $15,000. The only numbers reported are $15,000 on Line 8 and $15,000 on Line 15. The $35,000 received and then spent are not reported.

2. Receipt of loan proceeds. For example, a parish receives a $15,000 Stokes loan. The receipt of the $15,000 is not reported. If the $12,000 is then spent on capital projects, the $12,000 is reported on Line 15. As the loan is paid off, the interest portion of the payments is reported on Line 14 and the principal portion on Line 15.

4. Parochial Report, Page 3 - Detailed Instructions

Background

Detailed instructions for preparing page 3 of the parochial report are provided here, because of the importance of these instructions for setting up parish charts of account and for correctly assigning transactions to accounts.

Filing Procedure

Every parish is required to submit an annual parochial report. It may be submitted online to the Congregational Research Office of The Episcopal Church at https://reports.dfms.org// in which case it is due on May 1. A hard copy must be mailed or delivered to our diocese.

The parochial report may also be submitted in written form to our diocese by March 1, in which case our diocese will submit it in digital form to the parent church. Since this involves extra work for our diocese, parishes are urged to submit their reports online.

A Spread Sheet to Prepare Page 3

An effective way to prepare page 3 of the report is to create a spread sheet with the parish's statement of activities down the left-hand column and the lines from the page 3 line spread across the horizontal columns. (See TH Forms - St. Wendy's Parochial Report Worksheet). Each line from the statement of activities is allocated to the proper column, which represents a line on PR page 3. Each column is totaled at the bottom, and that number then goes to the appropriate line on page 3. Note that in the St. Wendy's worksheet there are no columns for PR page 3 lines that have nothing in them.

The only number from St. Wendy's statement of activities that is not allocated is the $15,000 Stokes loan proceeds received during the year. Loan proceeds are not reported, but the $13,500 of the proceeds paid out during the year for the rectory kitchen renovation project are reported on Line 15, Capital Expenses.

Summary of Instructions for Preparing Page 3

The instructions in the Manual may be summarized as follows -

OPERATING REVENUES, Lines 1-7.

Line 1	Signed Pledge Cards • Include all cards received from adults and children during the year • Include even if the pledger has died or moved away.

Line 2	Total Dollar Amount • Include the total for each card reported on Line 1 even if not paid and not expected to be paid.
Line 3	Plate, Pledge, and Regular Support • Include gifts for special days, and all miscellaneous, unrestricted gifts, and also all gifts restricted for operating purposes such as flowers or clergy support
Line 4	Money from Investments used for operations • Includes all interest, dividends, and distributions received from investments. Includes a percentage (e.g. 4%) of existing invested funds withdrawn based on the "total return" policy and used for operating expenses. Includes amounts withdrawn or transferred from existing funds into the parish checking account to be used for operations. Note: Line 4 on the parochial report form says, "available" for operations from investments. This is misleading. Include on Line 4 only money used for operations.
Line 5	Other Operating Income • Include NET income from space use, i.e. gross income less direct expenses related to providing the space to occupants • Include NET income from fund raisers, i.e. gross income less the direct expenses of conducting the fund-raising activities. • Include money received from parish groups, i.e. from the ECW or from a thrift shop or from a day-care operated by the parish. • Include grants from other than our diocese. Grants from our diocese go on line 7.
Line 6	Unrestricted Bequests used for operations • During the year parishioner, John Smith, died and willed the parish $25,000 of which $10,000 was spent on operations and $15,000 was added to the endowment. Include $10,000 on Line 6 and include $15,000 on Line 9.
Line 7	Assistance from diocese for operating budget • Include only grants from our diocese for operating purposes. • Include grants from our diocese for capital improvements, such as Green Grants, on Line 8. Include grants from our diocese for outreach/mission on Line 10.

NON-OPERATING REVENUES, Lines 8-11.

Line 8	Capital Funds, Gifts and Additions • Include new amounts actually received as gifts, contributions, or grants during the year and as additions to funds but ONLY if the amounts are restricted or designated for CAPITAL purposes, i.e. for the purpose of land, buildings, construction, or for major capital projects. • Do not include interest, dividends, distributions, or gains/losses on investments. Do not include loan proceeds received, e.g. Stokes Loan proceeds received, even if eventually intended for a capital project. • Do not include insurance payments received for damage to property (e.g. fire or flood) even if the payments are intended to repair the damage.
Line 9	Additions to Endowment and other investment funds • Include new amounts received as gifts, contributions, or grants during the year and as additions to funds (either restricted or unrestricted) but only if the new amounts are NOT spent. • Include any surplus from operations that is transferred to an endowment or investment account (and reduce Line 3 or 4 by a corresponding amount). • Do not include amounts restricted or designated for capital purposes, which are reported on Line 8. • Do not include any amounts that are used for operating expenses during the year, which are reported on Line 5. • Do not include interest, dividends, distributions, or gains/losses on investments, even if those are not spent and retained in the investment account.
Line 10	Contributions/grants for Congregation-operated programs • Applies only if a parish itself operates an outreach/mission program, such as a summer camp, a soup kitchen, or an after-school program. • Include contributions/grants received during the year for such congregation-operated programs. Do not include amounts that are part of the regular annual budget to be spent for outreach/mission activities. Amounts spent from Line 10 contributions/grants are reported on Line 16.
Line 11	Funds for transmittal to other organizations • Include amounts raised during the year to help some specific charity outside the parish, e.g. Heifer International or Episcopal Relief and Development, or for a priest's discretionary fund. When the amounts raised are passed on, they are then reported as a non-operating expense on Line 18.

OPERATING EXPENSES, Lines 12-14

Line 12	Assessment • Include amounts paid during the year with respect to any year's assessment.
Line 13	Outreach from the operating budget • Include amounts given to others for outreach or mission programs run by organizations outside the parish, e.g. to Heifer International, or to a priest's discretionary fund, and paid for from operating revenues rather than from the proceeds of special fund raising. (Expenses for such programs run by the parish itself are reported on Line 16)
Line 14	All other operating expenses • Include all regular and ordinary expenses (not including expenses reported on Lines 12, 13, and 15 capital expenses). (See TH - Capital Expenses and Depreciation)

NON-OPERATING EXPENSES, Lines 15-18

Line 15	Major improvements and capital expenditures (See TH) • Capital Expenses and Depreciation). If capital expenses are incurred during the year repairing damage from casualties (e.g. fire or flood), and if the parish has received or expects insurance reimbursement, then the amount paid for repairs is NOT reported anywhere in the parochial report.-
Line 16	Expenses for congregation-operated outreach/mission programs • Applies only if a parish itself operates an outreach/mission program, such as a summer camp, a soup kitchen, or an after-school program. Include expenses during the year for any such congregation-operated program. Contributions and grants for such programs are reported on Line 10.
Line 17	Funds contributed to Episcopal seminaries
Line 18	Funds transmitted to other organizations • Include amounts sent to help some specific charity outside the parish, e.g. Heifer International or Episcopal Relief and Development, when the amounts have been raised specifically for that charity. (The amounts so raised are reported on Line 11).

AT YEAR-END, Lines 19-20

Line 19	Total Cash • Include the total balances in all cash accounts (checking, savings, money market, etc. but not CDs) maintained in the name of the parish, including any clergy discretionary accounts and the accounts of parish groups such as the ECW, a thrift shop, or an after-school program
Line 20	Total investments at market value • Include the total market value at year-end of all CDs, mutual funds, stocks, bonds, and other investments, including the cash balances shown on the year-end statements from any brokerage accounts or investment accounts.

5. Statement of Financial Position (SFP) and Accounting Basis

For-profit enterprises have balance sheets. Instead, churches and other non-profits have statements of financial position (Manual III-11), and this is the name that QuickBooks uses for the report. Statement of financial position is commonly abbreviated as 'SFP'.

Most parishes in our diocese use a modified cash basis method of accounting, which is permitted by the Manual i-4, III-12. If a parish is using cash basis accounting, the parish should consider whether year-end adjustments in the form of accruals or deferrals are desirable to assure that the financials do accurately present the parish's financial position. At a minimum such adjustments should include recognizing all liabilities and deferring prepaid pledges.

The SFP can be viewed as being built in steps. First comes the current assets and the related net asset accounts. There are often several net asset funds "commingled" in the parish's main checking account and its money market account. Other funds are "segregated," i.e. there is only one fund in a particular financial institution account. Thus, the amount of the net asset fund equals the amount in the financial institution account. In the following example the thrift shop and the discretionary fund are segregated funds -

Current Assets			**Net Assets**		
1000	Main Checking	$15,000	**Restricted Funds**		
1100	Money Market	$25,000	3245	Stained-Glass Fund	$12,000
1200	Thrift Shop Account	$4,000	3250	Discretionary Fund	$2,000
1300	Discretionary Account	$2,000	**Unrestricted Designated Funds**		
1590	CDs	$25,000	3250	Roof Reserve	$18,000
			3450	Thrift Shop	$4,000
			3900	Operating Fund	$35,000
Total Current Assets		$71,000	**Total Net Assets**		$71,000

In this example the Stained-Glass Fund, the Roof Reserve, and Operating Fund (totaling $65,000) are commingled in the main checking account, the money market account, and the CDs (totaling $65,000).

The Manual requires that all checking and other accounts, maintained under the auspices of the parish (such as a thrift shop or an ECW account or the rector's discretionary account), must be included in the statement of financial position, even if the check registers are not kept in QB, and particular transactions to those accounts are not entered into QB, and are not included in the parish's statement of activities. (Manual III-12). But the year-end balances in those accounts are included on line 19 of page 3 of the parochial report.

The Manual requires that the funds in the SFP's net asset section should be divided into restricted funds and unrestricted funds. Restricted funds are those subject to restrictions placed by the donor on how money in the funds may be used. Unrestricted funds are those not subject to donor restrictions, but they may designated for specific purposes by vestry. (Manual III-11) (See TH - Restrictions, Designations, and Net Asset Fund Accounting. See also THFE - St Wendy's Balance Sheet)

The next step in building the SFP is adding other assets, such as investment accounts and real estate:

Assets			**Net Assets**		
Investments			**Restricted Funds**		
1710	DIT – Smith Trust	$100,000	3110	Smith Trust	$100,000
Real Estate			**Unrestricted Designated Funds**		
1810	Church (as assessed)	$1,245,000	3210	Church (as assessed)	$1,245,000

(For the treatment of the church see TH - Real Estate)

Assume the parish has taken out a $15,000 Stokes Loan during the year. The $15,000 loan proceeds are treated as other (non-operating) income, so, for example, when the proceeds are deposited, they are assigned to account 6100 Stokes Loan Proceeds. At the same time, the loan should also be accrued as a liability to fairly present the parish's financial position. The debit is to the 3999 account renamed "Less Total Liabilities." (See TH - Chart of Accounts):

Acct #	Account	Debit	Credit
2100	Stokes Loan Outstanding		$15,000
3999	Less Total Liabilities	$15,000	

The accrual adds the $15,000 liability and reduces Total Net Assets by the same amount.

(See THFE - St. Wendy's Balance Sheet)

6. The Statement of Activities (SOA)

For-profit enterprises have income statements, which are sometimes referred to as profit and loss (P&L) statements. Instead, churches and other non-profits have statements of activities, commonly abbreviated as 'SOA'.

Basic Concepts

QuickBooks organizes the Statement of Activities as follows:

Income	$W	4000 accounts
Expense	$X	5000 accounts
Net Ordinary Income	$W - X	
Other Income	$Y	6000 accounts
Other Expenses	$Z	7000 accounts
Net Other Income	$Y - Z	
Net Income	$W – X + Y - Z	

In the Chart of Accounts there is no account, Net Ordinary Income, Net Other Income, or Net Income. QB automatically calculates these lines and inserts them into the SOA.

Instead of the QB terminology, the Manual and page 3 of the parochial report uses the categories operating income/operating expense, and non-operating income/non-operating expense.

Operating Income is the ordinary and regular income being received by the parish, e.g. pledge, plate, fund raisers, space use, flowers, etc. Operating Expenses are the ordinary and regular expenses of operating the parish. For parishes Operating Income should be credited to the Operating Fund, and Operating Expenses should be debited to the Operating Fund.

The parish budget typically is a budget of Operating Income and Operating Expenses.

Non-Operating Income and Non-Operating Expenses are credited and debited to funds other than the Operating Fund. For example, gifts for the Endowment, for a Music Fund, or for a Capital Project Fund are Non-Operating Income and should be credited to the intended fund, not to the Operating Fund. Similarly, Non-Operating Expenses are those that will be paid for out of some fund other than the Operating Fund. For example, if during the year a parish pays $5,000 for major organ repairs, and is paid for by a withdrawal from the Music Fund, then the parish should record the $5,000 paid as a Non-Operating Expense and should at some point debit the Music Fund by this amount.

Every dollar coming into the parish during the year should be assigned to an operating or non-operating income account, an account numbered in the 4000s or the 6000s respectively.

Every dollar disbursed should be assigned to an operating or non-operating expense account, an account numbered in the 5000s or the 7000s respectively.

Thus, assuming a parish uses the cash basis method of accounting (as most do), then Net Income/Loss equals the overall cash flow surplus or deficit for the period covered.

At the end of each year the results of operation must be assigned to the specific net asset funds on the statement of financial position. (See TH - The Year-End Closing - December-January Checklist, January #5)

7. The Statement of Funds Activities

The Statement of Fund Activities ("SFA") is intended to provide a clear picture of all the changes in a parish's fund balances over the year. (See THFE - St. Wendy's Statement of Fund Activity)

This is an optional statement. The more funds that a parish has, the more likely it is that the use of this form will be useful to provide an overview of fund activity.

The parish's funds should be organized by type: (a) restricted funds and (b) unrestricted funds (which includes unrestricted designated funds and property/plant funds). (See TH - Restrictions, Designations, and Net Asset Fund Accounting)

The balance of each fund at the beginning of the year is stated, and then there are columns for:

- Income (Receipts)
- Expenses (Disbursements)
- Transfers in or out
- Investment gain or loss if the fund was invested in marketable securities, and
- Year-end balance.

Note that the sum of the transfers column is zero. Every transfer in or out went to, or came from, one of the other accounts.

The SFA presents a fuller picture of a parish's fund activities than appears in the statement of financial position. Particularly, if a parish has a significant number of funds, it may be preferable to only summarize fund balances by category in the statement of financial position and then have a SFA to provide fuller disclosure to the vestry of all the changes to fund balances during the year.

The example Statement of Fund Activities also includes a year-end reconciliation of the various funds commingled in St Wendy's checking and money market accounts.

8. Budgeting, Authorization to Spend and Contract Bylaws

Budgeting

Budgeting is the allocation of the parish's resources in accordance with a plan, and it is one of the most effective tools available for the proper stewardship of the parish's assets. (Manual I-1). Each year the vestry should establish a plan and a timeline for its budget process and stewardship campaign. (Manual I-2)

Discerning the congregation's mission and ministry is the foundation of budget building and should involve all members of a parish, where possible. When many people share ideas and opinions about congregation-sponsored programs their acceptance and support for the budget will likely be enhanced. (Manual I-3)

The budget should include all expected receipts and disbursements for the year and should show the expected cash flow surplus or deficit. Our diocese is required to have a balanced budget, and, while not required for parishes, parishes are urged to try to have balanced budgets as a general practice.

Typically, parish budgets only include operating receipts and disbursements. Better practice is to include not only operating receipts and disbursements but also all expected non-operating receipts and disbursements, separated out from the operating receipts and disbursements as they would appear on the monthly statement of activities.

It is recommended to include principal payments on loans, such as Stokes loans, in the operating budget (although they are reported on Line 15 Capital Expenses of the parochial report), because such payments are regular and expected.

It is also recommended that the operating budget include some amount for capital expenses. (See TH - Capital Expenses and Depreciation.) Annual planning should include some attention to capital needs. If not addressed in the annual operating budget, then there should be some consideration of a separate capital budget. (Manual I-4)

Approval of the Budget

Neither the Manual nor our diocese's Model Bylaws specify who is to approve the budget. Therefore, most parishes will not have a bylaw provision that states who is to approve the budget. Such parishes may have some discretion in establishing a budget approval process.

However, our diocese's Model Bylaws vest the parish's prudential affairs in the hands of the vestry, not the parish as a whole, and adopting the budget is generally considered to be a vestry responsibility. The general practice in our diocese is to have the vestry approve the budget, and this is what our diocese recommends.

The budget should then be presented to the parish Annual Meeting and explained. There should be opportunity for discussion and questions. The Manual states:

> *The budget presentation goal is to have the congregation consider and embrace the budget as its own - not the Vestry's budget or the rector's budget.* (Manual I-3)

Authorization to Spend and to Contract Under the Bylaws

Approval of the budget constitutes an authorization to spend the amounts budgeted for the purposes budgeted. Thus, for example, if the budget provides a salary for the rector of $72,000 for the year, no further authorization is required for the treasurer to make each monthly $6,000 payment.

In general, budgeted line item amounts should not be exceeded without vestry approval. For example, if fuel oil has been budgeted for $6,000, and the treasurer receives a $1,000 invoice in December after $5,500 has already been spent, the treasurer is not technically authorized to pay more than $500 on the invoice. Treasurers should be alert to advise their vestries of anticipated overruns on line items and to seek additional payment authorization. The recommended form of vote is to authorize an addition amount to be paid for a specific line item, not to amend the budget.

Our diocese's Model Bylaws give the vestry the power to manage the business affairs of the parish. In general, the wardens and the treasurer are given duties, not powers, but the Bylaws provide in Article 13.1 -

> *The Vestry may delegate to the Wardens and/or Treasurer generally or in particular cases the authority to execute contracts, deeds, leases, bonds, notes, checks and other instruments which may be necessary or proper.*

Assume a parish has budgeted $10,000 for maintenance. During the year at a time when less than $7,000 has been spent on maintenance, it is decided to paint part of the interior of the rectory, and a quote for $3,000 is obtained. Is vestry authorization required? When the budget was approved, would the vestry have understood that rectory painting was contemplated, or is this rectory painting something unusual? Before starting the work did the contractor ask for a signature on a document titled, "Painting Contract?"

When in doubt, it is always prudent to seek specific vestry authorization in advance.

9. Real Estate Issues

Churches, rectories, and other real estate are, in general, owned by the individual parish, but are held in trust for our diocese. Under Diocesan Canon 18, in almost no circumstances may parish real estate be "alienated or encumbered" without the prior written consent of the Bishop. A parish's church, rectory, land, and other real estate, if any, should appear in the net asset section of the Statement of Financial Position as designated assets, e.g. a *Plant Fund*, barring the existence of a donor restriction on the use or disposal of the property, in which case it should be listed as a restricted fund. While counter intuitive, the requirement for bishop consent does not make the fund restricted in the accounting sense of the term. Only donors can cause a fund to be restricted. (See TH - Restrictions, Designations, and Net Assets Accounting)

What is an "encumbrance" requiring diocesan permission? A mortgage clearly is an encumbrance, and so, if a parish wishes to take out a loan secured by a mortgage on its rectory, permission of our diocese must be obtained. A one-year lease of a rectory is generally not considered to be an encumbrance, but a longer lease will probably be considered to require diocesan permission. A multi-year license for a large portion of the parish house, for example to a day care center, may possibly be considered an encumbrance depending on the terms of the licensing agreement. When in doubt seek advice from our diocese.

The Manual requires that real estate be listed on the Statement of Financial Position (SFP) at its cost or, if donated, at the fair market value on the date of receipt (Manual III-9). Many parishes do not have such cost data, so some alternative must be found. It is recommended to use the value assessed by the Assessors' Office of the city or town where the real estate is located. Most towns and cities in Massachusetts keep their assessors' data base online, so the assessed value is readily available. Since this is a non-standard method, it should be disclosed on the SFP. The easiest way to do this is to make the disclosure in the account name itself, i.e. *1800. Church (as assessed).* (See THFE - St. Wendy's Balance Sheet)

Note that some towns and municipalities do not regularly update the assessment on properties that are exempt from the real estate tax.

Another alternative is to use the reimbursement cost limit from the parish's insurance policy. But this number has nothing to do with either cost or market value. In fact, the insurance policy number may be substantially in excess of value. Also it does not take into account the land underlying the church or rectory.

Since neither assessed nor insured value are consistent with cost accounting methodology, a more satisfactory approach may be to report these values in footnotes to the financial statements rather than adding the values to the SFP figures. This would give users of the SFP an overall understanding of the church's financials without potential distorting the accounting figures.

10. Capital Expenses and Depreciation (Parochial Report Line 15)

Definition of Capital Expenses

Every treasurer must distinguish between capital expenses and operating expenses. Usually this means adopting a definition of a "capital expense," and any expense not falling within that definition is then treated as an operating or a non-operating expense. Care should be taken to avoid misclassifying capital items as operating expense, because parish assessments are determined based on a percentage of operating expenses (Line 14 of the parochial report), whereas capital expenses are reported on Line 15 and hence not included in the calculation.

There is no clear definition of capital expenses in the Manual. The Manual discusses capital expenses in three different places that are not entirely consistent:

1) In the Manual's bookkeeping chapter, there is a suggestion that a capital expense involves an expenditure of $1,500 or more for something that has a life expectancy of three years or more. (Manual III-9)
2) The instructions for Line 14 of the parochial report say that, while ordinarily buying prayer books is an operating expense, a "large" replacement defined as more than 10% of the parish's total prayer books could be a capital expense.
3) Finally, the instructions for Line 15 in the parochial report say that capital expenses are *additions to property, major repairs tending to extend the life of the property, new equipment other than normal replacement, and any other improvements or major purchases that would be capitalized in conventional accounting*.

The Manual does recommend *…that the Vestry establish an asset capitalization and depreciation policy. It is important that the Vestry establish designated funds set aside for major future repairs and replacement needs for all capital items.*

Depreciation

For-profit businesses typically capitalize certain expenses and then depreciate those amounts over the lifetime of the assets involved. This is done in part, because (1) the tax laws do not allow capital expenses to be expensed in the year incurred, and (2) a capital gains tax will be due on disposition of the asset if the amount realized exceeds the basis, which is cost less depreciation. These two reasons do not apply to churches.

While GAAP requires capitalizing expenses and taking depreciation, the Manual does not require churches to keep their books in compliance with GAAP. There is little reason for a small or a medium sized church, particularly one that keeps its books on the cash basis, to capitalize expenses and take depreciation, and so most of those churches do not.

One reason for taking depreciation is to recognize that a church's capital assets are wearing out over time and eventually will need to be replaced. Thus taking depreciation becomes a way to build up a capital reserve fund. A problem with this approach is that the amount of the depreciation taken per year is calculated based on historical costs and not on a plan that estimates the future capital needs of the parish. It is desirable for medium to large parishes to have a Property Committee, one of whose functions is to predict the capital needs of the parish.

Whether or not depreciation is accounted for, a process should be in place to ensure that capital items are written off when they are disposed of or reach the end of their useful life,

It is recommended that parishes include in their regular annual budget some reasonable amount each year for capital expenses. For example, St. Wendy's has Account 5640 Capital Expenses. If a capital expense is paid for out of the Operating Fund, for example to buy a computer for the office or an appliance for the parish hall kitchen, then the expense is assigned to 5640.

St Wendy's also has a Capital Projects Fund, account 3330. If a capital expense is paid for from the Capital Projects Fund, then the expense is treated as non-operating and assigned to account 7010 Capital Project Fund Disbursements.

If at year end the full amount budgeted for capital expenses has not been paid out, then the balance should be transferred to the Capital Projects Fund so that it will be available for capital expenses in the future. (See the discussion of Capital Budgeting in the Manual I-4)

11. The Sustainable Use of a Parish Endowment

The vestry of every parish must balance the long-term and the short-term needs of its parish. Sometimes operating funds should be set aside for the future, which, in effect, prioritizes the long-term needs of the parish over the short-term needs. But there are also times when some savings, or some parts of the parish endowment, should be spent down, which prioritizes short-term needs over long-term needs. What is the policy towards a parish endowment that evenly balances long-term versus short-term needs? It is also important to ensure the endowment is managed in manner that complies with the legal requirements of Commonwealth of Massachusetts Chapter 180A *Uniform Prudent Management of Institutionl Funds*, especially if withdrawals are at a rate that seems likely to exhaust the endownment.

In the present investment environment the traditional approach of withdrawing only the interest and dividends from a parish's endowment is biased in favor of the long term needs of the parish, because in recent years the cash return on stocks and bonds has been low in relation to the appreciation on stocks. Therefore, the trend has been to think of withdrawals in terms of percentages of invested funds rather than in terms of the actual interest and dividends paid. This is referred to as the "total return" approach.

Financial advisors over the years have struggled with the question of what is a responsible or sustainable rate of withdrawal from an individual's savings or from an institution's endowment. There is no unanimous agreement on a withdrawal rate, and the optimal withdrawal rate probably varies from one person to another, from one institution to another, and from time to time. But most numbers suggested generally fall within the range of 3-5%. The rate of 4% is so widely used that it is sometimes referenced as the "4 percent rule."

Presently the Trustees of Donations ("TOD"), the Episcopal corporation that oversees the Diocesan Investment Trust ("DIT"), have settled on the goal of growing parish investments in the DIT at the rate of 4% plus the rate of inflation. For example, if a parish invests $100k with the DIT and allocates it between the stock fund and the income fund in the percentages that the DIT recommends, then the DIT's goal for average long-term growth is 4% plus the rate of inflation per year. Thus, at the present time, if a parish withdraws 4% per year from its endowment invested with DIT, the remainder can reasonably be expected to be growing at the rate of inflation, and the parish's endowment can be reasonably expected to sustain its long-term purchasing power.

Our diocese on Dec. 5, 2013, approved an Investment Policy Statement that appears in the document section of our diocese's website, and that provides in part:

> *Each year's Convention, through the adoption of a budget, adopts a spending draw for the year. Recent conventions have adopted draws between 4% and 5% of the three years trailing average of quarterly or monthly fund values. One interpretation of recent practices is that the value of 4% is the "usual" spending policy draw, and increases above that have been seen in response to "special" circumstances. A 4% draw is also the policy used by the TOD for its trust funds.*

Thus, our diocese has adopted the "total return" approach to withdrawals from our diocese's endowment.

Our diocese is required to have a balanced budget, but our diocese has not imposed this requirement on our parishes. Rather, parishes are urged to have balanced budgets, but it is recognized that for some parishes this is not always possible. Indeed, for some parishes with large church buildings and limited membership it may rarely be possible to have a balanced budget.

Therefore, in particular situations, our diocese considers it within the prayerful discretion of a parish vestry to treat up to 4% of its funds that are invested with DIT or in the stock market as operating income to pay operating expenses.

This 4% rule does not apply:

1) to funds that are not invested in the stock market. For example, if a parish endowment is held in a money market fund, the yield may only be 1-2%. Hence the only operating income is the interest and dividends actually paid by the money market fund, or
2) to funds where the use of the income is restricted, unless the restriction or designation specifically permits the use of the income to pay operating expenses.

Some argue that the 4% rule should not allow parishes to withdraw amounts that would result in a fund being reduced to less than the amount at which it was originally established.

Obviously, market conditions can change from year to year, and parishes making withdrawals from their invested funds should periodically review the reasonableness of the rate of withdrawal. If the growth of the invested funds over several years does not keep up with expectations, then it may be necessary to reduce the withdrawal rate.

In calculating the amount to be withdrawn using a percentage, it is common practice (as, for example, referenced in our diocese's policy statement) not to use the amount of invested, unrestricted funds as of the last year end, but rather to use a rolling average, for example, of the balances as of the last 12 or 16 quarters to take into account market fluctuations.

12. Restrictions, Designations, and Net Asset Fund Accounting

Creation of Restrictions

A restriction is a donor-imposed limitation on the power of the vestry to deal freely with a specific fund or with a particular asset. Thus, a restriction is in derogation of the basic powers of the vestry to manage the prudential affairs and to care for the property of the parish. Restricted funds need to be distinguished from designated funds.

Funds are considered restricted only if the donor has specified that the gift, or income from the gift, is to be used for a specific purpose. Unrestricted funds may be designated by the vestry for a specific purpose.

At law restrictions on the transfer of property are disfavored. Three things are required to create a restriction on a parish vestry:

1) There must be clear intent on the part of the donor to create a legal restriction, namely a restriction on the power of the vestry to exercise its discretion in the use of the gift.

2) The restriction must be expressed with sufficient specificity to be capable of legal enforcement. The wording of the restriction must be sufficiently clear that the vestry knows what it is permitted to do with the gift and what it is not permitted to do. And

3) The vestry must vote to approve the acceptance of the gift subject to the restriction, thereby recognizing the limitation on its powers. (Manual III-3)

It is common for parishes to receive gifts "in memory of" someone. This does not create a restriction. First, there is no clear intent to create a restriction or to limit the power of the vestry. Second, the wording is too vague to be capable of legal enforcement. If a gift is "restricted to use for the general welfare of the parish," the intent to create a restriction is expressed, but the wording of the restriction is so broad and vague as that it is not capable of legal enforcement.

By contrast a gift to be used "only to acquire a memorial to be placed in the church" is a restricted gift, because a limiting intent is expressed by the use of the word "only," and the permitted use of the gift is set out with reasonable clarity.

To complete a restricted gift the vestry must still accept the gift. The acceptance of unrestricted gifts of cash is presumed at law, and so no vestry action is required to complete such a gift. But restricted gifts can be burdensome and inappropriate. Problems with memorials have caused our diocese to include the following provision in our diocese's Model Parish Bylaws:

> *No object intended as a permanent addition to the Church or Parish property, or to be used therein during public worship, shall be accepted as a gift or memorial without the approval of the Rector and the Officers. All objects so accepted may be removed when deemed necessary by the Vestry. (Article 13.5)*

For large gifts it is common that the donor and the priest or a warden will discuss the gift in advance, and the terms of the gift can be negotiated to the satisfaction of all.

A restriction may be viewed as a legal contract with a donor. In exchange for the gift the vestry votes to comply with the restriction. Thus, the restriction becomes a legal obligation of the parish and binding upon the current vestry and future vestries.

Generally, under most parish bylaws, neither the rector nor the senior warden nor any other officer, acting alone or jointly with other officers, has the power to enter into a contract on behalf of the parish. So, the vestry should vote to approve the acceptance of any restricted gift. (Manual III-3)   Here is a sample vote:

> *VOTED: That the gift of $10,000 from Jack Smith is hereby accepted subject to the restriction that the principal and any earnings thereon shall be used solely for the benefit of the parish's music program. In the parish's financial statements this gift shall be identified as the Smith Music Fund (temporarily restricted).*

The vote then becomes a documentary record of the exact status of the fund.

A parish treasurer should assure that documentary records are maintained of the history of all fund accounts that appear in the statement of financial position or the parish accounts and of the wording of all applicable restrictions and designations. (See Manual, Ch. II, Internal Controls, II-17). A treasurer should be in a position to provide accurate advice to the vestry as to which funds of the parish may be used for what purposes. (Diocesan Model Parish Bylaws, Article 10.2)

Some contracts of restriction are created by implication. For example, a parish may undertake a capital campaign and prepare literature describing the uses that will be made of the funds raised. Checks and pledges are received that may say "only for the capital campaign". But there clearly is an implied promise that the funds raised will be used only for the purposes set out in the campaign literature, which should have been approved by vestry vote before being disseminated. The campaign literature, if carefully drafted, should have contained a provision as to what would be done with any excess funds or any funds left over after the stated goals of the campaign have been met or after the campaign has been terminated.

Unfortunately, as to smaller gifts, there is often ambiguity as to whether a gift is "restricted" or only "designated" (see below), and if it is restricted, what the wording of the restriction is. A check may arrive by mail with only a note saying, "For the flower fund." Is this a restricted gift or a designated gift? With large gifts it is good practice for the treasurer or another officer to speak to the donor to inquire whether the donor meant the gift to be restricted or designated. As a practical matter, this procedure is often not followed with small gifts. With a small gift the donor response to such an inquiry might well be, "I have not really thought about it," or "What do those words mean?" Or "What is the difference?"

It is generally not in the interest of a parish to have numerous restricted gifts, nor to have a proliferation of small restricted accounts. Imagine that a beloved parishioner has died, and at the memorial service 20 $50 checks are received, many with slightly differently words written on the check and some with no additional words at all. How many different restricted funds, if any, have be created?

If small gifts are ambiguous as to whether or not they are subject to a restriction, a vestry may reasonably conclude that the gifts are not restricted. Vestries may consider adopting a policy creating a presumption that gifts will be considered unrestricted unless a particular procedure is followed to create a legally binding restriction. (See THFE - Sample Parish Policies for Gifts and Funds)

Net Asset Fund Accounting

The rules for the preparation of a parish's Statement of Financial Position are set out in the Manual, particularly in Ch. III, Bookkeeping. Parish net assets (the not-for-profit accounting replacement for "owners' equity") are to be reported in two categories, restricted (which may be subdivided into permanently restricted funds and temporarily restricted fund, and unrestricted. (See Manual III-11).

1. Permanently Restricted Funds

Such funds are rare. For example, a parishioner, John Smith, might provide in his will for a $100,000 gift to the parish "to be held by the parish in perpetual trust with the income distributed to the parish annually for its general use." The parish then would report in its statement of financial position under the heading "Permanently Restricted Funds, Smith Trust $100,000." If the trust regularly produced annual income of $4,000, then the parish could budget $4,000 as operating income from the Smith Trust.

More often perpetual trusts are left to our diocese with the income to the parish. When the DIT holds the funds, they are held in the name of the parish, so the fund should be listed on the parish's statement of financial position. If a trustee does not hold the funds in the name of the parish, then the fund should not be listed on the parish's statement of financial position.

2. Temporarily Restricted Funds

Most restricted funds fall into this category. The use of the principal and interest of the fund is permitted but only for a particular purpose. There are three types of temporary restrictions:

1. Use Restrictions: This is the most common type of temporary restriction. For example, the use of the principal and interest of the fund may be restricted to supporting Christian education, or the music program, or the beautification of the church and grounds, or some other specified purpose

2. Process Restrictions: A parish must complete a defined process or event

3. Time Restrictions: For example, a parishioner may pay in December his pledge for the following calendar year. This amount should be treated as subject to a time restriction until the following January 1, when the restriction lapses, and the amount becomes unrestricted pledge income. Funds invested in certificates of deposit are often subject to a time restriction.

3. Designated Funds

Designated funds have a stated purpose, but vestry powers have not been limited. Therefore, the funds are not restricted. Rather the funds are subject to an expectation or a preference or an intention of the donor or of the vestry. However, in particular circumstances the vestry may vote to use the funds for some other purpose than the original designation.

Two examples:

1) A vestry might vote to set aside $20,000 to establish a fund for capital improvements. These funds are designated, not restricted (Manual III-11). A subsequent vestry can vote to rescind the designation and use the funds for any purpose.

2) A parishioner might send in a $500 check with a brief note that she would prefer that the money be used to support the music program. A preference is not a restriction. The vestry will usually end up using the money for the music program, but in special circumstances the vestry may vote to use the gift for other purposes.

A parish always has some amount of operating funds that are unrestricted and can be considered as designated for general operations or for whatever purpose the vestry decides. The relevant portion of a hypothetical parish's statement of financial position might look like the following:

Designated (Unrestricted) Funds	
Capital Improvement Fund	$20,000
Music Fund	$1,500
Operating Funds	$14,456
Total Designated Funds	$35,956

If this parish encountered a need for funds to pay operating expenses, the vestry could vote to use portions of the $1,500 in the Music Fund, or portions of the $20,000 in the Capital Improvement Fund, as well as portions of the $14,456 in the General Operating Fund, for operating expenses.

With many parishes in our diocese struggling with budget deficits, it is vital for parishes to have a clear understanding of the status of their funds. The best way to achieve this understanding is for treasurers to assure that the parish financial statements clearly present the classification of parish funds in compliance with the Manual.

One of the important responsibilities of the parish treasurer is to assure that funds are used only in compliance with any applicable restrictions or designations, unless with respect to a designated fund there has been a proper vestry vote authorizing a different use from the use originally designated. In order to fulfill this responsibility, the treasurer needs a clear understanding of what restrictions or designations have properly been established and are in current effect. (See THFE - Sample Parish Policies for gifts and Funds, Para. 9)

Every treasurer should be able to prepare a Summary of Fund Restrictions and Designations (See THFE Sample Summary of Fund Restrictions and Designations) for his or her vestry. It is recommended that each treasurer distribute and review such a report at least once a year, for example at the first vestry meeting following the parish annual meeting when newly elected vestry members are in attendance. In this way it can be assured that all new vestry members understand the restrictions and designations that apply the parish's funds.

13. Loans

The loans that parishes typically take out are long-term loans, i.e. payable in equal monthly installments over an extended period such as ten or fifteen years. Hence such loans are recording on the statement of financial position as long-term liabilities.

According to GAAP the loan payments coming due during the year are current liabilities rather than long term liabilities and hence should be reported in a separate part of the liabilities section of the statement of financial position from the long-term liabilities. But parishes are not required to keep their books in conformance with GAAP and most do not. Most parishes do not divide their loans between current liabilities and long-term liabilities, because there is little reason to do so.

Also, according to GAAP, the interest and principal portion of each month's loan payment should be accounted for separately, because the interest portion is an operating expense and the principal portion is a reduction of indebtedness. According to the instructions for preparing the parochial report, the interest portion is reported on Line 14, and the principal portion is reported on Line 15 as a capital expense. Hence a few parishes do not include the principal portion in their annual budget, and it does not show up in their statement of activities.

This practice is strongly discouraged. Both the principal and the interest portion of the loan payment are regular and predictable cash disbursements that are required to be paid. Hence it is recommended that they should be budgeted and included in the statement of activities in order to give an accurate picture of the cash flow of the parish.

Generally, there is no reason to bother splitting each monthly payment between principal and interest. The easiest and most practical approach is to split the total payments for the year at year end based on the numbers provided in the annual loan statement from the lender.

Assume a parish receives a $20,000 loan. Assume that before the receipt of the loan proceeds, the parish statement of financial position is as follows:

Checking Accounts	$35,000	Liabilities		$0.00
Investments	$150,000	Net Assets		
Fixed Assets	$700,000	Restricted Funds	$800,000	
		Designated Funds	$40,000	
		Operating Fund	$45,000	
		Total Net Assets		$885,000
Total Assets	$885,000	Total Liabilities & Net Assets		$885,000

The receipt of the loan proceeds creates a fund that is temporarily restricted to the purposes of the loan. A journal entry is required to reflect the transaction, as follows:

	Debit	**Credit**
Checking Account	$20,000	
Loan Liability		$20,000
Restricted Loan Proceeds Fund		$20,000
Less Total Liabilities	$20,000	

The account "Less Total Liabilities" is a net assets account and is necessary because the loan does not increase parish net assets.

After this journal entry, the statement of financial position will be:

Checking Accounts	$55,000	Loan Liabilities		$20,000
Investments	$150,000	Restricted Net Assets	$800,000	
Fixed Assets	$700,000	Restricted Loan Proceeds	$20,000	
		Designated Funds	$40,000	
		Operating Fund	$45,000	
		Less Liabilities	($20,000)	
		Total Net Assets		$885,000
Total Assets	$905,000	Total Liabilities & Net Assets		$905,000

Assume that at the next year end the loan balance has been reduced by $1,500 with everything else remaining the same. A journal entry is required:

	Debit	**Credit**
Loan Liability	$1,500	
Less Liabilities		$1,500

So the statement of financial position will be:

Checking Accounts	$55,000	Loan Liabilities		$18,500
Investments	$150,000	Restricted Net Assets	$800,000	
Fixed Assets	$700,000	Restricted Loan Proceeds	$20,000	
		Designated Funds	$40,000	
		Operating Fund	$45,000	
		Less Liabilities	($18,500)	
		Total Net Assets		$886,500
Total Assets	$905,000	Total Liabilities & Net Assets		$905,000

14. The Year-End Closing: A December-January Checklist

The following is intended as a checklist for treasurers' and bookkeepers' consideration. Not all issues will apply to all parishes.

December

1. Housing Allowance

If you will be paying your priest a housing allowance next year, have the vestry adopt a housing resolution, specific to the next year, before the end of the year. Utility allowances are covered by the same provision of the Internal Revenue Code and a require an authorization vote as well.

2. The Annual Audit

If you have not already made arrangements, consider whether you will be having an audit and who should do it. The Canons of the Episcopal Church. Title I, Canon 7, requires an annual audit. The auditor should be appointed before the end of the year so that the auditor can participate in the year-end closing.

3. Budget/Review of the Chart of Accounts

Start or continue work on your next year's budget. As part of that process review your chart of accounts. Do the lines on your statement of activities match up with the lines in your budget so that your Budget v Actual Reports are meaningful? Are there accounts with such small amounts, or such little activity, that they can be merged or eliminated? Are there accounts that have such large dollar amounts that they should be broken down into two or more accounts?

4. Pledges for the Present Year

Review your pledges receivable report with your priest and wardens. Are any pledgers significantly behind in their payments? If so, what action, if any, should be taken? Are there pastoral issues as well as financial issues?

5. Pledges for Next Year

In whatever software you are using for your pledge accounting (see December No. 13 below), be sure that, as pledges are received, the name and address of each pledger is entered and the amount of the pledge. For pledges received before January 1 date them January 1. After January 1 pledges may be dated the date on the pledge card, the date the pledge was received, or January 1.

6. Prepaid Pledges for Next Year

Prepaid pledges are temporarily restricted funds, so they should be received as non-operating prepaid pledge income in the present year, not as operating pledge income. But they should be entered as a donation in the present year so that they will appear on the year-end pledge statement as a tax-deductible gift in the present year. As of Dec. 31, they will be swept into a net assets fund, Prepaid Pledges, by a closing journal entry.

7. Bills Owed

Try to pay all bills on hand by the end of the year. Most parishes do not enter bills or liabilities as Accounts/Payable when received. If that has been your practice, prepare a list of all known liabilities that have not been paid at year end. The total should be accrued by a journal entry so that it appears on the year-end statement of financial position.

8. Pass Throughs

Go through all the pass-through receipts that have not yet been paid out and pay out as many of these as reasonably possible. Funds still held on Dec. 31 will need to be swept into a net assets account by a journal entry so that they are reflected on the statement of financial position.

9. 1099s

Check back over the year to make sure you have identified each person to whom you should issue a 1099. Particularly check your supply clergy, substitute organists, choir section leaders, other professional musicians, bookkeepers, and auditors. If you are using a payroll processor, make sure that it is clear who will be responsible for issuing the 1099s.

10. Uncashed Checks/Deposits Not Received by the Bank

Review your 11/30 reconciliation report on your main checking account. Checks outstanding more than 6 months are "stale" and should be voided. You may wish to void checks that have not been outstanding quite that long. Consider contacting the payees to determine whether their checks have been lost and whether duplicate checks should issue before year end. On a month-to-month basis any deposit that you believe you made, and that does not appear on the next bank statement, should be investigated.

11. Consider Closing Out Some Accounts and Funds

Simplify your life! Do you really need all those bank accounts? Do you really need all those net assets funds, particularly the small ones? Can any accounts be merged, closed, or deleted? Can the amounts in any funds be zeroed out or any funds merged?

12. Review the Form of Your Regular Reports

Is there any reason to revise any of the reports that you regularly prepare?

13. Pledge Accounting Software

The use of pledge accounting software is highly recommended. Examples of such software are Donor Statements by Big Red Consulting, Servant Keeper, and Realm. If you are not already using such software, December is a good the time to consider starting for the following year.

14. Dec. 30-31 Transactions

Date 12/29 any transactions that occur on 12/30 or 12/31. Back-dated transactions will be dated 12/30 (see January No. 1). It is desirable that the only transactions dated 12/31 will be the closing journal entries. This allows financials before all closing journal entries to be compared to financials after all closing journal entries, e.g. compare the statement of financial position as at 12/30 with the statement of financial position as at 12/31, or compare the statement of activities for Jan. 1-Dec. 30 with the statement of activities for Jan. 1-Dec. 31.

January

1. Backdating Transactions

While not ideal, it is sometimes desirable during the early part of January to backdate some transactions to the prior year. For example, if 12/31 was a Sunday, and there was a Sunday collection that was not deposited until January, this deposit should be backdated, because the date of gifts is the date of receipt, not the date of deposit, which is, in effect, a transfer of a receipt that has already occurred. Also, some bills may be received in early January that relate to December expenses. Consider backdating the payment of such bills if it will result in a more meaningful alignment of income and expenses against your prior year's or next year's budget. Date all back-dated transactions 12/30 so that they can be clearly identified at a later date.

A particular problem is checks dated in December but received by the parish in early January. IRS rules state that the gift is made when received (i.e. in January), and so, in general, the date of such gifts may not be backdated to December. There is an exception for checks that come by mail in an envelope bearing a December postmark.

2. December Reconciliation

Make sure that all transactions that are going to be backdated have been backdated before the year-end reconciliation is done. The reconciled year-end balance should equal the check register balance in your accounting system.

3. Recognize Your Prepaid Pledges

Enter a journal entry to recognize your prepaid pledges as current year pledge income. If you have entered pledges as unpaid invoices, issue a credit for each prepayment so that the invoice will show an accurate balance unpaid on the pledge.

4. The Closing, Part 1: Review of Transactions

Preferably with the assistance of the auditor, review the assignment of transactions for the year to accounts. Care needs to be taken to make sure that non-operating receipts and disbursements have not mistakenly been assigned to operating accounts, and that non-operating receipts and disbursements are matched to the correct net assets funds involved. If the treasurer or bookkeeper has any questions about account assignments, refer them to the auditor. The auditor should also review all journal entries made during the year.

5. The Closing, Part 2: Statement of Financial Position Adjustments - Results of Operations

If the parish is not using sophisticated software, such as QuickBooks, Church Windows or ACL Realm, a journal entry must be made to transfer the results of operations to the statement of financial position. For example, assume that the prior year balance of the Outreach Fund was $10,000, and that during the year there were $3,000 in receipts for the fund and $9,000 in disbursements. The amount of the fund must be reduced on the statement of financial position by $6,000 to $4,000. The same must be done for each net asset fund that had receipts or disbursements during the year.

6. The Closing, Part 3: Statement of Financial Position Adjustments - Events Not in the Accounting System

The amount of many of the line items in the statement of financial position changes because of events that are not recorded in the accounting system. For example, investment gains or losses will be reported on the year-end statements received from the DIT or other investment company. Loan balances should be adjusted to match the principal owed on the year-end statement from the lender. The check register for some bank accounts (such as the rector's discretionary account) are usually not kept in the accounting system, and so the year-end balance must be taken from the appropriate bank statements. If the parish is carrying its real estate at assessed value, the current assessed value must be checked.

It is desirable to have arranged for online access to DIT statements (easy to do), because the year-end statement is often available online substantially before the printed statement is received in the mail. Call Charlie Jordan at our diocese, 617-482-4826 x557.

7. Initial Preparation of Page 3 of the Parochial Report

The spreadsheet available on our diocese's website should be used to allocate all the numbers on the statement of activities to specific lines on page 3. This process may lead to adjustments being made in the statement of activities. For example, transactions that were entered as operating expenses in the statement of activities may be reallocated to space use expenses, capital expenses, outreach/mission expenses, or other non-operating expenses.

8. Finalize the Budget and Obtain Vestry Approval

The budget should be finalized and approved by the vestry prior to the Annual Meeting so that it can be presented for questions, discussion, and comments (not approval or other action).

9. Finalization of Reports for the Annual Meeting

The diocesan model bylaws provide in Article 10.2 that it is the treasurer's duty to present at the Annual Meeting a "full statement" of the parish's receipts and disbursements and of the parish's "financial condition.". It is recommended that the annual meeting report should include (1) the parish's statement of activities for the year with comparison to the budget, (2) the year-end statement of financial position with comparison to the prior year (Manual, III-10), and (3) the vestry-approved budget for the new year, all1 as prepared directly by the parish's accounting software.

To assure the accuracy of the reports to be presented at the Annual Meeting, (a) the year-end closing (See January Nos 4-6 above) must have been completed prior to the Annual Meeting, and (b) it is desirable to have involved the auditor in this process. This will also simplify and speed the audit to follow.

10. Tax and Legal Compliance

In order to document tax compliance, assemble and file together all tax documents for the prior year, such as the 941s for the four quarters, W-2s, and 1099s. Verify that other legally required documents such as W-4s and I-9s have been prepared for each employee and filed in the proper personnel file.

11. Inventory/Property Records

Each January it is desirable to conduct some reasonable form of review to determine whether church property is present or accounted for. This may involve nothing more than inquiring of clergy and staff whether any property is missing. A related issue to consider is church security - are all doors that should be locked reliably kept locked? Have there been any instances of unauthorized persons gaining access to the church or parish hall?

In the event of loss (for example due to theft or fire), a parish needs to be able to document its insurance claim. Every parish should have a file, preferably kept off site, with photos of property, and depending on the value and nature of specific property, appraisals, invoices, records of counts, and other documents that would be needed to support a claim. Aside from the church and rectory, a parish's most valuable piece of property may be its organ or its stained glass. Has any new property been acquired over the prior year that should be photographed or documented?

15. The Annual Audit

General

Annual audits are required for all parishes (Episcopal Church Title 1 Canon 7 Section 1 (f) and (g))

The person(s) to perform the audit should be engaged prior to the end of the year to be audited to allow the auditor to participate in the year-end closing (Manual VI-4), and our diocese's Model Parish Bylaws state that the auditor(s) shall be appointed at least thirty days before the end of the year. (Article 13.3)

The audit should be filed with our diocese no later than Sept. 1 of the year following the year being audited. (Manual VI-5)

Most parishes in our diocese do not hire a CPA to perform a financial audit because of the expense involved and because most keep their books on a cash basis in accordance with the standards in the Manual and not in compliance with GAAP. As a result, the potential benefits from a formal CPA audit may be outweighed by the expense of such an audit.

Parishes may have their audits performed by an audit committee that typically has three members, but the size may be determined by the size and scope of the audit. (Manual VI-3) The audit committee must have sufficient expertise in church financial affairs and church administration to appropriately interpret, apply, and evaluated the results of the audit program. Audit committee members must also be free of potential conflicts of interest for those areas they are assigned to audit. For example, committee members must not audit activities they performed or for which they were responsible.

If a parish cannot find an auditor on its own, our diocese can recommend persons who have experience in performing audits for Episcopal parishes. Alternatively, some CPAs will perform 'agreed upon procedure' engagements structured on the audit program contained in Manual VI.

Please be aware that financial statement compilation and review services offered by CPAs are *…not acceptable in place of an audit of a parish, mission, or other institution of the church.* (Manual VI Introduction paragraph d 1).

The Manual provides an Audit Program Checklist (Manual VI-6), an Internal Control Questionnaire (Manual II-12), and various instructions to guide the audit.

The Checklist and the Questionnaire set out a lengthy list of questions. Parishes are not required to do everything that is asked about. Rather the auditor is required to ask each question and record the answer.

For example, there is a question, "Are two signatures required on checks for $500 or more?" (Manual VI-8) Many parishes have no requirement of two signatures, and so the auditor will mark the "No" box after the question. When the audit report is being written, the auditor considers what recommendations to make to improve parish financial policies and procedures. It is within the discretion of the auditor whether or not to recommend a two-signature policy for the specific parish. This will depend on the circumstances. Most parishes, in fact, do not have any two-signer requirement.

Our diocese has established an Alternative Audit Procedure for parishes with operating expenses of less than $200,000 for the year being audited. This procedure is somewhat more streamlined than the audit procedure contained in the Manual. The document setting out the procedure appears as an attachment to the Business Practices Resources section of our diocese's web site.

Other Steps in the Audit

It is desirable for the auditor to be appointed in December of the year to be audited, so that the auditor may participate in the year-end closing. (See TH - The Year-end Closing, a December-January Checklist)

The auditor will make an audit visit to the parish, at which time he or she will make an extensive review of the business records of the parish. After this, the auditor writes a report that includes a listing of any problems observed and recommendations made. The report is presented to the Treasurer, Rector, and Wardens. The Treasurer or other responsible persons are required within 30 days to present to the Vestry a written response, essentially an action plan for dealing with the issues raised by the audit report. (Manual VI-4) This response then becomes a part of the audit report. The Vestry reviews and votes to accept the report, and it approves and votes to adopt the responses. (Manual VI-4 and see TH Forms - St. Wendy's Audit Findings and Vestry Response)

The submission to our diocese must include the auditor report, the parish financial statements, the written response/action plan for the recommendations made in the report and documentation such as meeting minutes or an attest letter signed by the vestry clerk stating that vestry has voted to accept the audit and the related response/action plan.

If the vestry does not meet in the summer, it is desirable to plan for the completed auditor's report to go to the vestry no later than the June meeting, so that it can be submitted to our diocese well in advance of the Sept. 1 due date.

16. The Annual Inventory, Documentation of Property, and Disaster Planning

Every parish must have some reasonable form of property inventory that at least covers capital assets. (Manual VI-17). But the Manual does not specific the amount of detail required. A detailed inventory is difficult and time-consuming to prepare, and generally unnecessary. Many parishes do not have any form of inventory, so their starting point is to create such a reasonable inventory procedure to be followed each January, thus providing reasonable assurance that all parish property is present or accounted for.

In terms of documentation there are two goals. One is to have appropriate records to support an insurance claim if specific property is stolen or destroyed by fire, flood, vandalism, or another contingency. The second is to have a list of the property that should be present to compare to the property that is observed to be present when the annual inventory is undertaken.

For most parish property a photo record is satisfactory. A person with a digital camera in an hour or two can take 6-8 photos per room, progressing through the church, parish house, and rectory. The photos can be stored in the cloud or otherwise off site.

To supplement the photos some additional information may be needed depending on the item of property. For many parishes, the most valuable piece of property is the organ. There should be a formal written description of the organ, noting, for example, the stops, the age and general condition, and anything else relevant to its value. Such a description may usually be obtained from the parish's organist or from the person who routinely services the organ. Items of high value, such as stained glass, silverware, or works of art, may need to be appraised. Some items, such as computers, are not well described by just a photo, but are described by the purchase invoice. Some items, such as chairs or tables, may need to be counted.

In terms of the verification process the rector, staff, and officers may be asked to perform some reasonable walk-through of the church and parish hall and queried as to whether they notice any parish property to be missing. A principal risk is theft, so there should be a discussion of security. Is the church and parish house kept reasonably locked? Have keys been controlled, or is there a need to change the locks? Have there been any instances of persons having unauthorized access over the prior year?

To protect the parish's property there should be some reasonable attention given to disaster planning. A first goal is to prevent disasters, such as theft, fire, or flood, from occurring in the first place. When a disaster occurs, there may be need for prompt action, so the person responsible for such action should be designated and some thought given to the nature of the parish's response.

17. Setting Up QuickBooks (QB)

Chart of Accounts

When a new QB file is created, it comes with a pre-entered Chart of Accounts with 5-digit account numbers. It is recommended that these accounts be deleted or hidden, and that the starting point for the Chart of Accounts for a new file should be the Chart of Accounts previously used by the specific parish, as modified with consideration of the Chart of Accounts Section of this handbook and of St. Wendy's Chart of Accounts.

Two of the accounts suggested by QB require special discussion -

Account 30000 Opening Balance Net assets

When a QB file is first opened, among the accounts that appear in the Chart of Accounts is the Account 30000 Opening Balance Net assets. It is recommended that this account never be used, and that it be deleted. Net assets balances must be assigned to specific net assets funds, e.g. the Building Fund, or the Music Fund, not a general fund, in order that the applicable restrictions and designations for the net assets fund can be known. (See THFE - St. Wendy's Balance Sheet)

When establishing a bank account, QB will ask for a starting balance. Do <u>not</u> put in a starting balance.

Use a journal entry to establish all initial balances of each specific asset account, including each bank account, and each net asset fund, e.g.:

		Debit	**Credit**
1000	Main Checking Account	$17,550	
1020	Money Market Account	$25,399	
1110	Certificates of Deposit	$15,000	
1600	DIT Endowment Account	$80,000	
		$137,949	
3100	Endowment Fund		$80,000
3320	Capital Reserve Fund		$20,000
3440	Flower Fund		$5,000
3500	Operating Fund		$32,949
			$137,949

This way all initial balances are established in one place where they can be easily modified later, if necessary, and there is certainty that credits and debits start in balance.

Account 32000 Retained Earnings

When a QB file is first opened, among the accounts that appear in the Chart of Accounts is the Account 32000 Retained Earnings. This account is required for for-profit businesses and cannot be deleted. An attempt to delete it may produce an "unrecoverable error". But churches do not report retained earnings.

When QB produces a statement of financial position, e.g. as of year-end, Dec. 31, it automatically includes at the end of the net assets section the line, say "Net Income $2,450". This number is taken from the bottom of the statement of activities for the year through the date of the statement of financial position.

If a statement of financial position is produced on the next day, January 1, then the line Net Income has disappeared, and the number $2,450 has been added to account 32000 Retained Earnings.

The 32000 account should be renumbered and renamed. It is recommended that it be edited to become "3900 Fund Adjustments." As part of the year-end closing, the results of operations, as shown on the statement of activities, must be allocated by a journal entry to specific net assets funds. For example, if net operating income for the year is $3,000, then this amount needs to be allocated to the Operating Fund. (For an explanation of this process see TH - Statements of Financial Position, and TH - The Year-End Closing, January #5)

Setting Preferences

In QB there are many opportunities to customize a parish's file. (Select *Edit, Preferences*) There follows a number of recommendations for settings.

After selecting *Edit, Preferences*:

- Select Accounting Preferences/Company - Check Use account Numbers and Require accounts. The use of account numbers is strongly recommended, and an account should be required for every transaction.

- Checking/My Preferences - Fill in the desired default bank accounts.

- Desktop View/My Preferences - Check Multiple Windows and Don't save the desktop.

- General/My Preferences - Uncheck Keep QuickBooks running

- General/Company - Check Use Undeposited funds as a default deposit

Items

The QB "items" feature was set up so that for-profit companies could keep track of the different amounts of income resulting from the sale of different products. Thus, a company selling 100 different products will define 100 different "items" in QB, which allows tracking how much of its total revenues resulted from the sale of each specific product.

Churches do not sell products. For churches "items" are used to track the different types of money coming in, i.e. to specify the specific income account to which a receipt should be assigned. The "item" is a short-cut name that is linked to a specific account. Thus, for example, "pledge" would be the item name linked to account 4010 Current Year Pledges, and "rent" would be the item name linked to account 4320 Rectory Rent.

Thus, there should be an "item" defined for each category of operating and non-operating income that exists in the parish's chart of accounts.

To define a new "item" select *Lists, Items, New*. For each item specify "services" as the type. For each income account make up a short-hand name to link to the account, e.g.:

Pledge	4010.	Pledge Income
Plate	4020.	Plate Receipts.
Flowers	4030.	Flower Fund
Buildings	6050.	Buildings + Grounds Fund
Endowment	6100.	Endowment Fund

The "item" will then be used identify each payment received, and there is no need to look up and enter the correct account number.

Classes

Business use classes to track separately all the income and expenses related to different stores or departments. Reports can then be prepared separately for each store or for each department and an overall report prepared for the whole business.

Similarly, a church that operated a day-care center on site might consider setting up church and day-care operations as two classes. Some books recommend using classes to keep track of different net assets funds. Neither of these uses are recommended. In general, for a church to use classes is more burdensome than the useful. Churches should be wary about implementing the QB class function.

Jobs

The Jobs feature of QB is designed to keep track of different contracts with the same customer. For example, assume a contractor works regularly for an apartment complex and may have, at any one time, a number of open contracts each requiring specific work to be done (say in different apartments in the complex) and specific payments to be made with respect to each apartment. Each contract is set up as a job, which is, in essence, a subcategory of the customer, e.g. Customer:Job1, Customer:Job2, Customer:Job3, etc. This allows the customer to be invoiced separately on each job and allows the contractor to keep track of the expenses incurred on each separate job.

Small to medium parishes will rarely need to use this feature.

18. Handling Transfers and Fund Withdrawals in QuickBooks

Between Bank Accounts

The most common situation involves the movement of money between two bank accounts, for example between the main checking account and the money market account. Suppose a parish has the following account balances on the statement of financial position:

1000	Main Checking	$5,000	3500	Operating Fund	$18,000
1020	Money Market Account	$20,000			

Assume the parish desires to transfer 10,000 from the money market account to the main checking account. If the transaction is affected online or by a phone call to the bank, enter the transaction by selecting *Banking, Transfers,* and fill out the screen to move the $10,000.

After the hypothetical 10,000 transfer the statement of financial position appears as follows -

1000	Main Checking	$15,000	3500	Operating Fund	$18,000
1020	Money Market Account	$10,000			

There is no change to the balance of the Operating Fund or of any other net assets fund, so there is no need for any further action.

Sometimes the transfer is be accomplished by writing a check on the money market account, in which case the check on account 1020 must be assigned to account 1000, which causes QB to record immediately the $10,000 as deposited in the main checking account. Thus, there is then no need to use the *transfer* function, and, when the check is deposited in the main checking account, the deposit should <u>not</u> be recorded, because to do so would create a duplicate deposit.

Between an Investment Account and a Bank Account

For example, a parish makes a special $20,000 withdrawal from its DIT account or from an account at some other investment firm to pay for operations.

Assume the relevant accounts on the statement of financial position before the transfer are as follows:

1000	Main Checking	$15,000	3200	Endowment Fund	$245,000
1600	Investment Account	$245,000	3500	Operating Fund	$5,000
				Net Income	$12,000

Assume that the investment firm issues a check to the parish for the $20,000. Withdrawals from funds for operating purposes are considered operating income. Thus in the St Wendy's chart of accounts there is account 4110, which is an operating income account, titled "Special Fund Withdrawals." So, when the money is deposited in the main checking account, it is assigned to account 4110, which recognizes operating income. This changes the statement of financial position as follows:

1000	Main Checking	$30,000	3200	Endowment Fund	$245,000
1600	Investment Account	$245,000	3500	Operating Fund	$5,000
				Net Income	$8,000

There must also be a journal entry to reduce accounts 1600 and 3200 by the $20,000:

		Debit	**Credit**
1600	Investment Account		$20,000
3200	Endowment Fund	$20,000	

Commonly this journal entry is not entered until year-end, because the statement of financial position is not updated during the year, but this is a matter for determination by the individual parish.

After this journal entry these accounts will show:

1000	Main Checking	$30,000	3200	Endowment Fund	$225,000
1600	Investment Account	$225,000	3500	Operating Fund	$5,000
				Net Income	$8,000

Parishes commonly receive regularly quarterly distributions from, for example, the DIT. One check may come from several different DIT accounts with different restrictions. Therefore, when deposited, the check will have to be split. For example:

4040	Flower Fund	$135
4070	Discretionary Fund	$80
3200	Capital Projects Fund	$340

If the distribution is by direct transfer (there is no check), then write a dummy check on the investment account, and make a dummy deposit, splitting it as above.

19. Other Transactions in QB

Pledges and Payments on Pledges

In QB, Customers equate to Pledgers for churches. At the start of a year define each pledger as a customer and create an invoice dated Jan. 1 in the amount of the pledge.

When a payment on a pledge is received, in the Home Page select *Receive Payments*. This handling of the receipt is essential so that the payment can be tied to the specific pledge, reducing the balance outstanding.

A single pledger may have two or more pledge invoices open. For example, there may be an unpaid balance on the prior year's pledge invoice. There may be the current year pledge invoice, and there may be a pledge invoice for, for example, a Capital Campaign. Each payment must be tied to the correct unpaid invoice.

All Other Receipts

For any receipt other than a pledge payment, select *Donation* or *Sales Receipt*. For each receipt, the Item is entered to identify the category of income (e.g. plate, rent, fund raiser, etc.). If the donor is known, he or she can be identified so the gift will appear on the donor's quarterly pledge statements (but not as a pledge payment). The receipt cannot be applied against any outstanding invoice.

Hand Checks and Dummy Checks

Assume that a purchase is made on behalf of your church, and the payment is going to be made by writing a check on your church's main checking account. This is a "hand check". Select *Banking, Write Check*, and input the information, including the actual check number, into the blank check that appears. In the top task bar of the Write Check window is a box "Print Later". Make sure that this box is not checked. Check this box if you wish to have the computer print the check and to assign the next check number.

A "dummy check" is a check that does not exist. For example, assume the telephone company automatically charges your church's checking account for the monthly fee. When the monthly bank statement is received, the charge must be added to the check register. This can be done by a journal entry but using a "dummy check" is recommended. In general, journal entries should not be used for routine transactions.

To create a dummy check, select *Banking, Write Check*, and fill out a check for the amount of the fee. Since there is no real check, put something other than a check number in the check number box. For example, if the next real check to be written would have been #3450, QB will have put that number in the check number box. Delete that number. For an online or an automatic payment, you can enter "online" or "auto". QB will accept text as well as numbers. If the payment is for payroll, you can enter "pr". If the charge against the checking account is a bank charge, you can enter "bank". Use whatever system you find desirable to identify "dummy checks" as opposed to real checks.

Investment Gains/Losses

Parishes typically receive DIT or other investment statements shortly after the end of the period involved. Assume, for example, receipt of a DIT statement in mid-July reporting account balances as of June 30, showing an investment gain or loss.

Investment gains/losses are not income/expense for cash basis Episcopal churches, so they do not have to be recorded in QB. The process is somewhat complicated, so it is recommended that it not be done. For most purposes it is sufficient to report periodically investment account balances to the vestry. The balances of investment accounts are usually adjusted on the statement of financial position only at the end of the year.

Prepaid Pledges

Assume on December 1 a parishioner makes a pledge for the following year. An invoice is entered in QB in the amount of the pledge, but the invoice is dated January 1. Assume that the parishioner on December 10 prepays $2,000 on his pledge for the following year. This pledge is not pledge income in the current year. It will become pledge income on January 1 for the year to which the pledge relates.

Each parish should have a nonoperating income account "Prepaid Pledges". The receipt on December 10 should be recognized as a "Donation" by the parishioner and assigned to this account. The receipt is not a payment on the parishioner's current year pledge invoice. The $2,000 will show up on the prior year pledge statement sent to the parishioner as a gift in the prior year but not as a pledge payment, and the parishioner can take a prior year tax deduction.

On January 1 by a journal entry the prepayment is recognized as pledge income. Also, a credit must be created against the new pledge invoice in the amount of the prepayment so that QB registers a correct balance owed.

Undeposited Funds

When receipts are entered into QB, for example by selecting *Donations*, there is no box on the screen to enter the bank account to which a specific receipt is to be deposited. Receipts may come in over a series of days before any deposit is made, and the receipts to go into different accounts may be intermingled.

QB automatically puts such receipts into a current asset account named "Undeposited Funds." Since the receipts are not yet deposited, the amounts are not yet added to the balances as shown in the registers for specific accounts.

When it is time to make a deposit, select *Banking, Make Deposits.* Select the specific deposits that are to be made to that bank or other accounts. Consider whether it is easier in your specific situation, (1) to make all deposits to the main checking account and then transfer amounts intended for other accounts to those accounts, or (2) to make a number of different deposits each going directly to the intended fund.

The situation may be simplified by having all your most commonly used funds commingled in the main checking account, e.g.

	Debit		**Credit**
Main Checking	$45,000	Flower Fund	$2,000
		Memorial Garden Fund	$3,000
		Capital Projects Fund	$25,000
		Operating Fund	$15,000
			$45,000

In such a situation all receipts for those funds may be deposited together into the main checking account, and there is no need to deal with transfers or separate deposits.

20. Accounting Software and Books

Introduction

Parishes handle their accounting with three basic categories of software.

Double-Entry Programs

The Manual specifies that parishes should using double-entry accounting.

QuickBooks ("QB") provides double-entry and is the accounting software used by many parishes in this diocese. QB Premier Edition offers a few special provisions for Non-Profits such as churches, but the basic QB package is usable.

Larger parishes sometimes use programs such ACS Realm or Church Windows, which offer more features than QB but are more complicated to use and more expensive.

Single-Entry Programs

Some small parishes that for various reasons do not wish to use QB or other double-entry systems, use Quicken or some other single-entry system. Quicken is much simpler to use than QB but is also much more limited in its features. Fundamentally, Quicken is an automated check book register. It does not fully implement basic accounting features nor support the complex financial reporting requirements of not-for-profit organizations like churches. While Quicken can be adequate for small parishes that have relatively few net assets funds to track and are able to work around its significant accounting and reporting limitations, it is recommended that such parishes periodically consider upgrading to QB.

Non-Accounting Programs

Some very small parishes do not use accounting software at all but use a standard spread sheet program, such as Excel. It is recommended that such parishes consider moving at least to a single-entry accounting package, such as Quicken, if not a double-entry package, such as QB.

One advantage of QB is that it is so widely used that a parishioner who becomes treasurer may already be familiar with it. When hiring an administrator or bookkeeper, a parish may find it easy to find applicants with prior QB experience. Also training programs are often available, and there are extensive training opportunities online.

Two recommended QB manuals are QuickBooks for Churches by Lisa London (Deep River Press 2d ed. 2014) and Running QuickBooks in Nonprofits by Kathy Ivens (CPA911 Publishing 2d ed 2011), both available on Amazon.

21. Supplemental Software

Introduction

Virtually all parishes use some accounting software package, such as ACS Realm, QuickBooks, Church Windows or Quicken. Most parishes also use additional software to supplement their accounting package, particularly for pledge accounting. Our diocese recommends that parishes consider computerizing their pledge accounting.

Supplemental software tends to be of two types: (1) add-ons to the particular accounting software package being used, or (2) stand-alone programs of a category commonly referred to as church management software.

Add-Ons to Accounting Software

Add-ons are specific to a particular, commonly used accounting package, and typically provide a single feature or function not provided (or not well provided) by the accounting package itself. Big Red Consulting is a company that specializes in such add-ons, providing add-ons for QuickBooks, Excel, and Quicken. (http://www.bigredconsulting.com)

Most parishes find that QuickBooks does not produce pledge statements to their satisfaction. There following add-on programs may be worth considering for this purpose:

1) Big Red sells an add-on, Donor Statements (approximately $100), which is used with satisfaction by several parishes in the diocese. (Works both with QB desktop and QB online). Big Red also sells a PayPal Link add-on for QuickBooks.
2) Beyond The Ledgers sells an add-on, Donor Letters with Details, and another program Batch Sales Receipts. (Each under $100).
3) Donation by Software4Nonprofits "…is an easy to use and powerful installed Windows program for charities and churches to track their donors and donations and issue charitable receipts." It has over 6,000 registered users. The one-time fee (approximately $100) includes a year of support and updates. The program may be downloaded free for evaluation.
4) Roll Call by ByTheBook. Cost varies with the number of donors to be handled. This program allows you to manage membership, attendance, donations & pledges as well as group & class information.

When using these programs, usually all pledge data is input into QB. The add-on program is launched while QB is running and the parish's QB file is open. The program then extracts all needed information from the QB file and prints out pledge statements.

Church Management Software

As an alternative to single-feature add-on programs, there are many multi-purpose programs sold to churches for membership management and other non-accounting functions including the production of pledge statements. One source of information about such programs and evaluations of church software is http://www.capterra.com/church-management-software.

Realm and Servant Keeper are examples of very successful "contact management" programs that also handle pledge accounting. Both these programs are used by parishes in our diocese. As an example of the versatility of these programs, in addition to pledge accounting Servant Keeper will also handle attendance tracking, child check-in, donation management, event management, group management, member directory, member profiles, membership management, multi-site management, newsletter management, online payments/giving, volunteer management, and worship planning.

Within this category of programs, all the pledge information, e.g. names, addresses, pledge amount, pledge payments, and other payments that will eventually appear on pledge statements sent to the donors, is entered into the programs. The program then uses this information to create the pledge statements. Periodically, say each week, a summary of the dollars input into these "stand-alone" programs needs to be input into QB. For example, a weekly summary might be recorded as follows -

Pledges	$3,275
Plate	$345
Flower Fund	$120
Capital Campaign	$2,500
Total Deposit	$6,240

The one-time price for the desktop version of packages of this type is usually in the range of $500 and varies with the size of the parish.