



*The Northern IL Conference Council on Finance and Administration and Board of Trustees
Presents:*

“PROTECTING THE COOKIE JAR”

A Workshop on Local Church Internal Controls

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Reflection

John 12:4-6, “But one of His disciples, Judas Iscariot, who was later to betray Him, objected, ‘Why wasn’t this perfume sold and the money given to the poor? It was worth a year’s wages.’”

He did not say this because he cared about the poor but because he was a thief; as keeper of the money bag, he used to help himself to what was put into it.”



Not In Our Ministry?

If one of Jesus' disciples could succumb to the temptation of stealing from the ministry money bag, we should not consider our own ministries immune to this risk.

There are 2 reasons to prevent fraud in our ministries:

- Protect the ministry
- Protect the employee

annual review

finance inheritance committee income disclosure economic
procedures confidence
monthly reports planning
charge conference giving transparency
Local church audit guide
Book of Discipline expenditures
value properties accounting
donations tithes practice audit
trust insurance dividends agreement stewardship

Overview

Fraud Prevention

Internal Controls

Examples

Resources

Questions



Fraud Prevention

Much of the fraud that takes place in ministries today is preventable. While we need to trust our employees (or they shouldn't be employed by us), we still have a responsibility to do our part in the prevention of fraud.

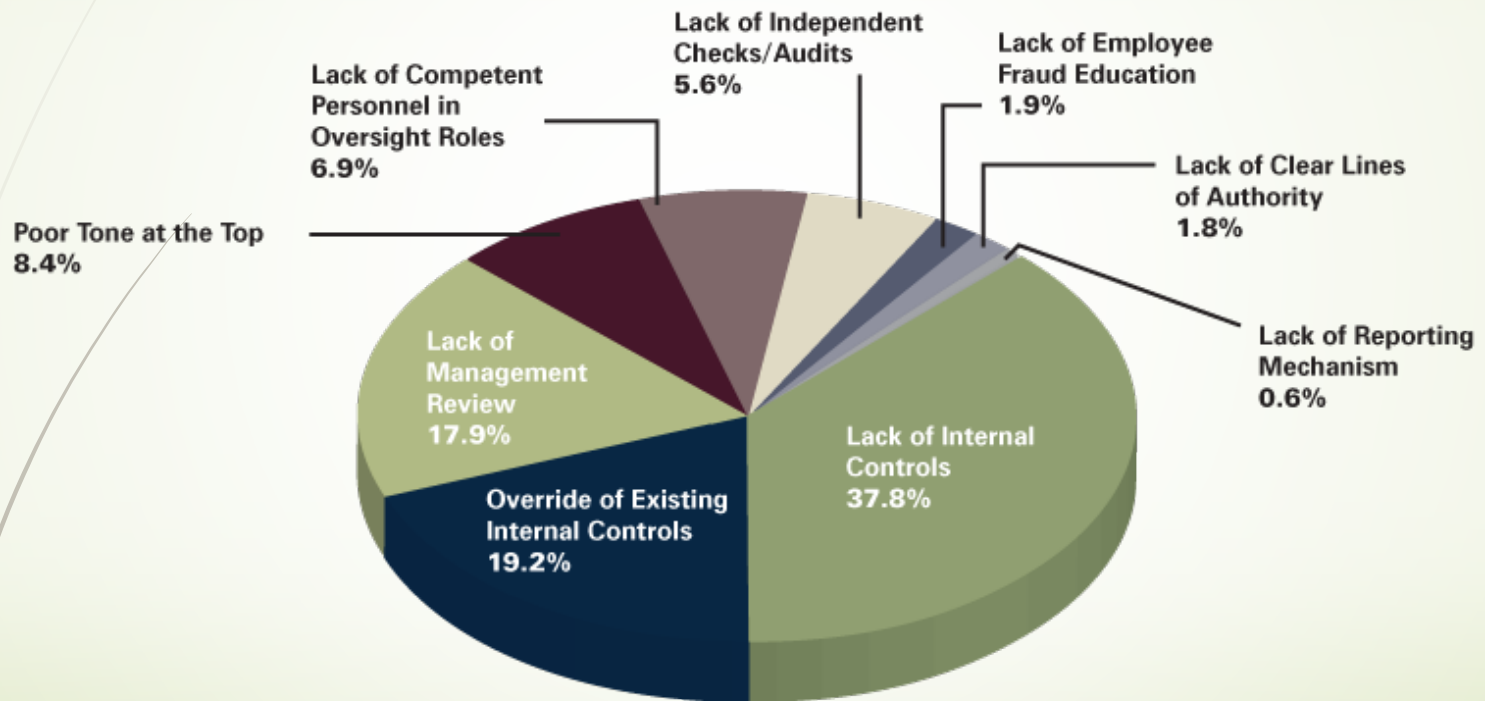
Trust is NOT internal control.


“We hire Christians” is not an internal control either!

Victim Organizations

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Primary Internal Control Weakness Observed by Certified Fraud Examiners in actual victim organizations






Organizational Fraud Factors

Weak internal controls and control consciousness:

- Too much trust – either in general or in one person
- No background checks on key employees
- Poor management oversight
- Nepotism – this can create a problem in hiring, managing or firing employees.



Organizational Fraud Factors

Weak internal controls and control consciousness:

- Weak internal controls in the areas of cash receipts, cash disbursements, and payroll
- Lack of financial audit – internal or external

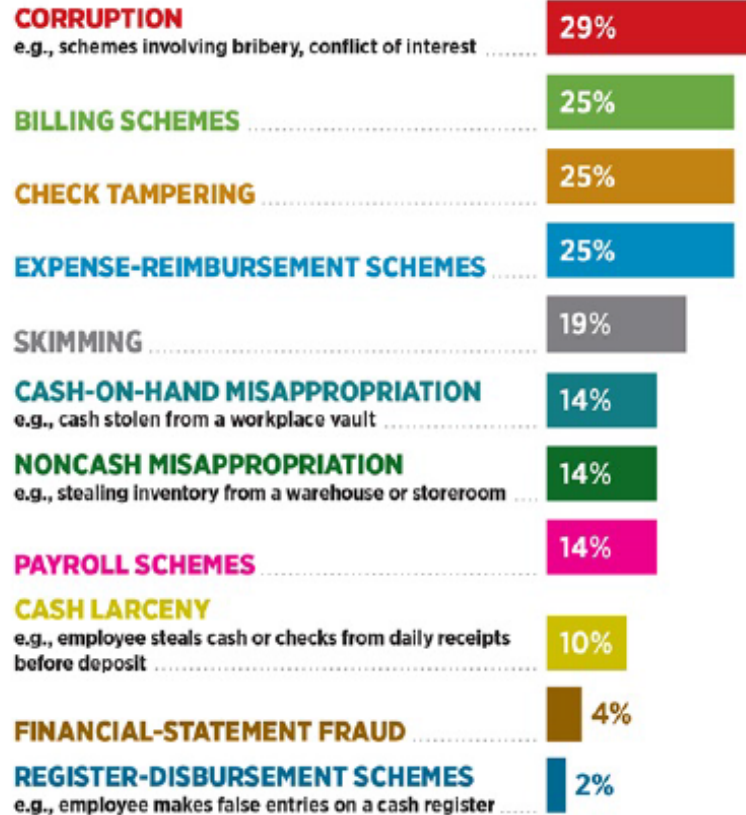


Environment for Fraud

Most individuals that commit fraud in ministry don't start working with the mindset of the organization being an "easy target". They have been faithful employees and have a heart and passion for what is being accomplished. The following slide reflects the "Fraud Triangle". Keep in mind that if two of the three elements exist, your ministry has a greater risk of being the victim of fraud.

11 Ways Employees Commit Fraud

The most common types of fraud experienced by religious, charitable, and social service organizations.



Source: Report to the Nations on Occupational Fraud and Abuse: 2016 Global Fraud Study, Conducted by the Association of Certified Fraud Examiners. Report based on 2,470 online surveys completed by Certified Fraud Examiners. Numbers are rounded to the nearest whole number. Question allowed for more than one answer; this total exceeds 100 percent.



Fraud Triangle





Opportunity Examples

- Absence of preventative measures and controls
- Inadequate segregation of duties
- Rapid turnover of employees or changes in management
- Constant operation under crisis conditions or rapidly changing environment
- Absence of mandatory vacations
- Failure to inform employees about company rules and the consequences of violating them or committing fraud
- Failure to uniformly and consistently enforce standards and policies or to punish perpetrators

Motivation Examples

- Overuse of personal credit cards
- High personal debt levels
- Loss of spouse's job
- Divorce or medical crisis
- Investment losses
- Greed
- Alcohol, drug, or gambling addiction
- Extramarital affairs
- Family or peer group expectations
- Needs of extended family – such as the grandmother that embezzled funds to help meet the medical needs of her grandchild



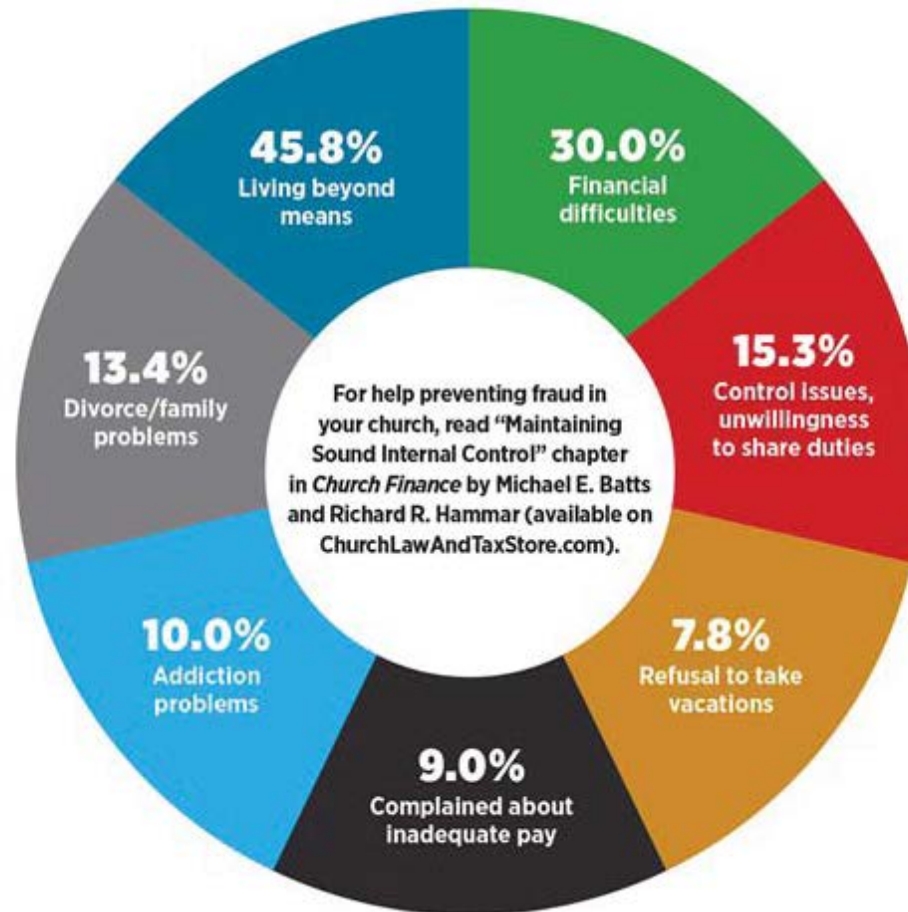
Attitude Examples

Some typical rationalizations or justifications for misappropriation of assets include:

- “The organization treats me unfairly and owes me.”
- “It’s for a good purpose.”
- “I have to do it for my family.”
- “They don’t pay me what I’m worth.”
- “I am only borrowing the money and I’ll pay it back.”
- “Nobody will get hurt.”

Behavioral Red Flags Displayed by Perpetrators of Fraud

Certified Fraud Examiners pinpoint these warning signs.



Source: Report to the Nations on Occupational Fraud and Abuse: 2016 Global Fraud Study. Conducted by the Association of Certified Fraud Examiners. Report based on 2,410 online surveys completed by Certified Fraud Examiners. This is a partial list of the 17 behavioral red flags listed on the survey. For the complete list, see Figure 94 on the survey—available in a downloadable PDF at ACFE.com.



Example

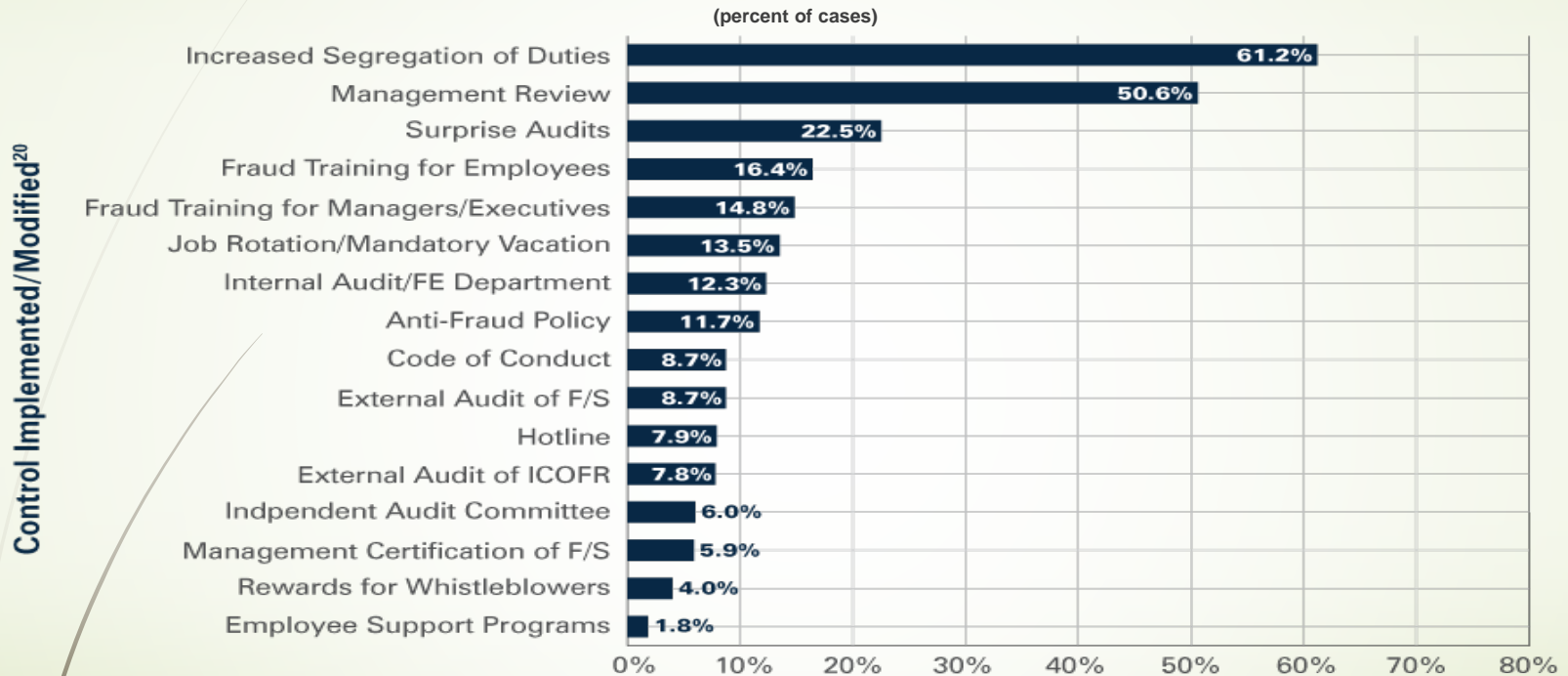
Each of the elements of the fraud triangle become more realistic when we look at an example of laying off staff due to budget cuts.

	Before Layoff	After Layoff
Opportunity	Good internal controls	Fewer staff and internal controls
Motivation	No pressure to steal	Bad economy, no raise or bonus
Attitude	Loyalty, team cohesiveness	Angry, scared workers with less loyalty

Response to Fraud

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Internal Controls Modified or Implemented in Response to Fraud*



*The sum of percentages in this chart exceeds 100% because many victim organizations modified more than one anti-fraud control in response to the fraud.

²⁰KEY:

External Audit of F/S = Independent external audits of the organization's financial statements

Internal Audit / FE Department = Internal audit department or fraud examination department

External Audit of ICOFR = Independent audits of the organization's internal controls over financial reporting

Management Certification of F/S = Management certification of the organization's financial statements

Prevention Techniques



Prevention Techniques

The next several slides will discuss various suggestions and procedures to minimize the risk of fraud occurring in your organization. It is a lengthy list and if you have several points missing in your ministry you may feel overwhelmed. It is probably best to find the ones that you feel are most important and just start implementing improvements. Each of your efforts will reduce the risk of fraud significantly.



Internal Controls

- **Internal control** is simply the various practices adopted by an organization to:
- **safeguard assets**
- check the **reliability and procedural accuracy of financial records**
- ensure **compliance with managerial policies**



Segregation of Duties

- ▶ The important thing to remember with all functions is that there should be separation between custody, authorization, and record keeping. Someone can do two functions, but not all three.
- ▶ Consider how this relates to your ministry and what areas may not have these functions handled by different individuals. Even with a small staff, this can be accomplished if you pay particular attention and make use of a variety of individuals, including volunteers.



Role of pastor

- The pastor or any of the pastor's family members should NEVER be allowed to (or required to, or left to do this because no one else will....)
 - Count offerings
 - Prepare member giving statements
 - Sign checks
 - Prepare financial statements
-
- Should the pastor be aware of congregation member giving?



Receipts

General steps to segregate in the cash receipts process
(a-authorization, c-custody, r-record keeping):

- Counting funds (c)
- Receiving funds (c)
- Preparing a count sheet (c)
- Preparing the deposit slip (r)
- Making the deposit (c)
- Entering in the subsidiary ledger (r)
- Reconciling the count sheet with subsidiary records and deposit slip (a)



Receipts cont.

- Treasurer and Financial Secretary should not be the same person and should not be in the same immediate family residing in the same household
- Counting team (at least two unrelated persons) should count offerings and document totals – not treasurer and not financial secretary
- Offerings should be deposited the same or next business day
- Offering count details should be given to financial secretary for recording
- Offering totals should be given to the treasurer or financial secretary to record deposit
- The Financial Secretary's deposit log should be compared to the bank statement to verify deposits (by bank reconciliation reviewer)



Cash Disbursements

General steps to segregate in the cash disbursements process (a-authorization, c-custody, r-record keeping):

- Approving invoices for payment (a)
- Inputting invoices in the subsidiary ledger (r)
- Writing checks (c)
- Signing checks (a)
- Mailing checks (c)
- Reconciling the subsidiary ledger with the general ledger (r)
- Reconciling vendor statements with the subsidiary ledger (r)



Cash Disbursements cont.

- ▶ The Treasurer should be authorized to make electronic payments of bills. The Treasurer should maintain support for every electronic payment just as with the support for paper checks.
- ▶ Invoices should be required for all payments from all accounts.
- ▶ Someone other than the treasurer (with authority by Finance Committee) should approve invoices for payment.
- ▶ Typically, the Treasurer should make payments only after the invoice is approved. A policy may be implemented where routine, budgeted expenses (i.e., rent/mortgage, electric bill, etc.) may be paid without recurring approval; non-routine expenses must be approved prior to payment.
- ▶ Financial policy and authority guidelines should be written and approved by the Finance Committee.



Payroll

General steps to segregate in the payroll process
(a-authorization, c-custody, r-record keeping):

- Approving new hires, salary and wage rates, bonuses, and terminations(a)
- Approving time reports (a)
- Entering payroll information (r)
- Approval of hours by a supervisor (a)



Payroll cont.

- ▶ W-2s must be issued for employees, including pastors and 1099's must be issued for nonemployee compensation by January 31 for preceding year (federal law requirement.) Payroll tax forms and deposits done as required for payroll amount (federal law requirement) – payroll reporting should be completed for the IRS and SSA by appropriate due date.
- ▶ Housing allowance or exclusions approved annually at charge conference and kept on file (federal law requirement)



Bank accounts and reconciliations

- ▶ At least two persons should be listed as authorized signatures on all accounts. This should also be the case for setting up electronic payments (or EFTs). For EFTs, one of those individuals should be a Trustee or a member of the Finance Committee (other than the Secretary or Treasurer).
- ▶ All accounts should be reconciled monthly
- ▶ Someone other than treasurer should review bank reconciliation at least semiannually – including bank statements, invoices, checks written, and financial reports
- ▶ The Treasurer should make detailed report of budget and designated fund activities to the Finance Committee at least quarterly



Information Technology

- ▶ We need to remember that while information technology isn't directly related to the financial statements it significantly impacts the processing. If proper controls are not established in this area, our ministries are at risk in many areas. Employees could have access to software that would negate our segregation of duties, we could lose days or more of data, or we would just have downtime that would lead to serious inefficiencies. Items to consider include:
 - ▶ Protect personal identifiable information and sensitive personal information
 - ▶ Password protect files
 - ▶ Use secure passwords
 - ▶ Do not leave computers unattended
 - ▶ Do not view church files when using public Wi-Fi
 - ▶ Do not respond to "phishing" emails
 - ▶ Do not click on links in emails from unknown sources



Prevention Techniques

If your organization already does a good job of having the proper policies and processes in place, keep up the good work. You will also want to look at these suggestions carefully and consider others on an ongoing basis to make sure it stays that way.

It is often easy for things to “slip” over time and systems to weaken without realizing that anything has changed.



Prevention Techniques

Set the tone at the top

This is crucial! If a system of good policies exists but it is well known that senior leadership circumvents the controls, all credibility and desire to comply is lost. It is also important that employees see these processes in a positive light and don't get the feeling that these are a "hassle" or "something to make accounting happy".



Prevention Techniques

Have a functioning audit committee

The audit committee ideally is a separate committee that is tasked with overseeing the audit process whether external or internal. They would also review the recommendations that were made by the auditors and make sure management implements them as appropriate. In smaller ministries, this committee's role may be fulfilled by the finance committee.



Prevention Techniques

Implement an internal audit process

An internal audit extends the benefits of an external audit throughout the year. The procedures may test procedures and transactions overall or by department. Most commonly in ministries, an internal audit function is used to test the controls of foreign field or satellite office locations or the results of a specific program or grant.



Prevention Techniques

Engage external auditors annually

Having an external audit is just one of many internal controls an organization should have. It is important that you use CPAs that are knowledgeable about ministries. You know how unique some of your accounting issues are, they should understand that as well.



Reliance on an External Audit

Leadership in an organization often believes that if they have an audit, they have taken the necessary steps to make sure that fraud hasn't or won't occur in their organizations. An audit is designed to determine if the financial statements are materially correct and doesn't specifically address fraud.



Prevention Techniques

Hire and promote the right employees:

Strict employment practices should include things such as criminal background checks, credit references, driving record check (if applicable), education verification, and possibly drug testing. Be sure to consult with an HR specialist or employment attorney to verify what is permissible in your state.



Prevention Techniques

Hire and promote the right employees:

Provide training!!!! A variety of training opportunities should be presented to employees to make sure they are given adequate growth potential. Especially training managers in fraud awareness can increase their level of competency as well as show the staff that you take it serious and have practices in place to prevent fraudulent activity.



Prevention Techniques

Hire and promote the right employees:

It is important to have conditions of employment agreements and employee manuals that are current and signed. Such agreements would authorize employers to inspect employee desks, offices, lockers, etc. It is not that you intend to constantly “invade” their space. It is another step in reflecting the emphasis on fraud prevention.



Prevention Techniques

Hire and promote the right employees:

You are unable to find out about past criminal activity of an employee unless it is reported. That should be considered if fraud occurs in your organization. While there are many factors to be weighed in the decision whether to press charges or not, realize that you may be protecting a ministry in the future.

Even people perceived as repentant have committed fraud more than once.



Prevention Techniques

Hire and promote the right employees:

Finally in this area, consider the use of dishonesty insurance (bonding). Because fraud seems to be committed by a variety of individuals and certainly by people that we trust, this insurance provides some protection against losses should they occur. You can check with your insurance agent on policies and rates.



Prevention Techniques

Hire and promote the right employees:

If you don't have the right internal resources you should consider **outsourcing**. There are many good outsourced solutions available:

- Full service accounting
- Controllership
- CFO-to-Go
- Payroll service
- Only buy what you need but with higher competency



Prevention Techniques

Involve the whole team – not just finance:

Take time to understand the risks the organization faces. This can be done in a brainstorming meeting that includes individuals from various departments. In a matter of a few hours, you could discuss questions like “What could go wrong?” “Where could fraud occur?” “How could it happen?”

Ask various people if they suspect any fraud in the ministry.



Prevention Techniques

Involve the whole team – not just finance:

An effective whistleblower policy should be in place which provides employees a reporting mechanism if they suspect fraud. The policy clarifies who to report to. Then the managers need to understand their role once a suspicion is reported. It is imperative that the reporting employee is protected from any negative repercussions.



Prevention Techniques

Involve the whole team – not just finance:

All employees need to know that their actions are being monitored—not in an overbearing or intrusive fashion—simply an awareness that people are alert. When they understand that this is true from the top down, they will appreciate the high standards. If fraud does occur, it may be very beneficial to publicize the efforts and results.

A healthy dose of fear may be a good deterrent at well.



Prevention Techniques

Involve the whole team – not just finance:

Working as a team can help identify redundancies or gaps. By standardizing and streamlining processes, it may simplify things and make it easier to keep the focus on important steps. Sometimes a process can be so complicated that procedures are excluded and no one understands the importance of why it should be done. Simple may be better.



Prevention Techniques

Conduct surprise visits:

Surprise tests can be conducted by internal or external auditors as well as by a member of management. Some areas to consider for this process would be:

- Petty cash counts
- Review payroll reconciliations
- Inspect HR files looking at benefits withheld and paid as well as verifying payroll information in a current report
- Select certain income and expense accounts to review transactions



Prevention Techniques

Watch for **red flags** of investment schemes:

There have been a few instances in the past several years of ministries losing money through this type of activity. We have a responsibility to be good stewards of the resources the Lord and our donors have entrusted to us. While the parable of the talents would lead us to believe that it is better to invest than to bury that treasure, there is still a level of prudence that is necessary. The following two slides will give some warning signals.



Prevention Techniques

Watch for **red flags** of investment schemes:

- Promises of low risk or high returns
- History of consistent returns – we all know that investments are typically NOT consistent
- High-pressure sales tactics
- Pressure to reinvest
- Complex trading strategies
- Lack of transparency
- Lack of segregation – be concerned about financial managers who manage, administer, and retain custody of the fund. There is more opportunity for fraud in this type of situation.
- The old adage, “if it sounds too good to be true, it probably is” should still be followed.



Prevention Techniques

Tips to avoid investment schemes:

- Ask lots of questions and make sure you know who you are dealing with.
- Check the investment manager's credentials.
- Seek professional, or at least informed, second opinions.
- Evaluate the pros and cons carefully, and focus on the cons.
- As with all investments, exercise due diligence in selecting investments and the people with whom you invest.
- Make sure you fully understand the investment before you invest any money.
- Don't be greedy!



Insurance

- Does the church have adequate insurance for:
- Property
- Liability
- Auto
- Workers' Compensation
- Umbrella

CCI Licensing

- Does the church have a license
- Do you display it on projections
- Do you reference it in bulletins



Examples – what went wrong?

- ▶ Pastor had the church write checks to a property management company out of the benevolence account. He said he needed it to provide rent assistance to someone in need. He told the secretary that he couldn't divulge the name of the beneficiary due to confidentiality.
- ▶ Pastor had actually created a fictitious property management company. He needed the money to fund his online gambling debts.
- ▶ No one was allowed to review the benevolence account activity.



Example 2

- A church's expenses keep increasing. Payroll costs are higher than expected.
- The bookkeeper would simply increase her pay rate when she needed money.
- No one reviewed the payroll register.



Example 3

- Bookkeeper was writing extra checks to herself. She recorded them to a receivable account.
- The bookkeeper had access to check stock, access to the signature stamp and was in charge of all bank reconciliations and journal entries.
- Clearly, the bookkeeper was not properly supervised. There was not an appropriate segregation of duties. This is a good example of trust gone too far.



Example 4

- ▶ Bookkeeper was taking checks from the mail and depositing them into her bank via ATM.
- ▶ She learned that ATM checks are not all reviewed and that the bank doesn't always match up payee to endorsement.
- ▶ Segregation of duties failed as they allowed her to be the only person with access to mailed in contributions. She was also in charge of manual receipting to donors so she could easily cover it up.



Example 5

- ▶ The organization MONTHS after the fact caught the CFO charging her family trip to Disney. That of course started a greater look into her charges and they found many personal charges which they required repayment of (and of course she was let go).
- ▶ The approval process failed. All expenditures should be approved before being paid. They should be approved by someone that knows what to look for and will question charges. Not getting proper support, business purpose and approval happens much more than it should.



Example 6

- ▶ Church was having trouble with increased expenses. Cash flow was getting significantly more challenging. No one could figure out why.
- ▶ Quickbook payees differed from actual payees on checks.
- ▶ The check registers were reviewed, but actual checks weren't reviewed. The check signer just signed checks without actually reviewing and examining checks. Office manager started out small, but got increasingly bold. The small church chose a close person that was trusted.
- ▶ Perpetrator was actually relieved when she was caught. She is now paying restitution and will pay for the rest of her life. Getting caught was a healing moment and she was relieved to break the cycle but couldn't do it on her own.



Example 7

- The church used a faithful volunteer to count the offering every week.
- This person did not choose to count the cash on Sunday. Instead he took it home, counted it, kept it, and wrote the church a check for the amount he kept.
- What's wrong here?



Example 8

- ▶ Church was behind in paying for construction bills. The treasurer kept making excuses for why the bill was not being paid. The church had a fire and was adequately insured. The insurance proceeds were deposited into a separate account.
- ▶ The treasurer opened the bank account and was the only person who had access to the account and its records. He was a trusted volunteer. He was a CPA and owned his own accounting firm.
- ▶ This case actually was investigated by the U.S. Securities & Exchange Commission.



Example 8 cont.

- This person also had access to several clients investments accounts. He “borrowed” money from client accounts by forging checks and “lending” them to other people for business ventures. These also included new businesses for family members and friends. One of his clients was a 96 year old woman with dementia. He “borrowed” from the church account, but then lost the funds through other investments and then the crash of 2008 happened and he could no longer cover his losses.
- The church treasurer stole \$1.3 million from the church.
- This perpetrator is serving a 12 year jail sentence.
- What went wrong?



Additional Resources online

- From The Book of Discipline on Finance

<http://www.umc.org/what-we-believe/para-2584-finance>

- Finance Committee expectations

<https://www.umcdiscipleship.org/resources/finance-committee2>

- Treasurer and Finance Training Resources

<https://nccumc.org/treasurer/training-materials/>

- Local Church Audit Guide from GCFA

http://s3.amazonaws.com/Website_GCFA/resources/local_church/Local_Church_Audit_Guide_101416_FINAL.pdf

- A Sample Internal control Policy and Procedures document

http://docs.arumc.org/finance-and-administration/Internal_Control_in_Churches.pdf



Additional Resources

- **Church & Nonprofit Tax & Financial Guide** – Dan Busby, Michale Martin, John Van Drunen
- **Essential Guide to Church Finances** (Richard Vargo & Vonna Laue, Christianity Today)
- **Minister's Tax & Financial Guide** – Dan Busby, John Van Drunen
- **Church & Clergy Tax Guide** – Richard Hammer
- GuideStone Financial Resources – **Ministers Tax Guide**
<http://www.guidestone.org/LearningCenter/Ministry/MinistersTaxGuide.aspx>
- **Church Law & Tax Report** – Christianity Today
- **Church Finance Today** – Christianity Today
- Christianity Today <http://www.churchlawandtax.com/>
- Evangelical Council of Financial Accountability (ECFA) www.ecfa.org



IRS Resources

- General Information 1-800-829-1040
- Tax Forms and Publications 1-800-829-3676
- Status of Refund 1-800-829-4477
- Web Site: www.irs.gov
- Pub 15 Circular E, Employer's Tax Guide
- Pub 15-A Employer's Supplemental Tax Guide
- Pub 15-B Employer's Tax Guide to Fringe Benefits
- Pub 463 Travel, Entertainment, & Auto Expenses
- Pub 517 Social Security and Other Information for Clergy
- Pub 526 Charitable Contributions
- Pub 1771 Charitable Contributions –Substantiation & Disclosure
- Pub 571 Tax-Sheltered Annuity Plans (403(b) plans)
- Pub 1828 Tax Guide for Churches and Religious Organizations



QUESTIONS?



Thank you!

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