	**Zion Lutheran Church Financial and Accounting Manual**	**SOP # 8**	
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Zion's Treasurers' and Bookkeepers' Financial and Accounting Guide

A resource provided by the Office of the Treasurer of the

Evangelical Lutheran Church Zion

Preface

This information is based on our best information at the time the guidelines were prepared. Updated resources can be found on the “Finance for Congregations” section of the Office of the Treasurer website.

www.ELCA.org/Resources/Financial

The treasurer of Zion Lutheran Church has the responsibility to be aware of current tax reporting requirements for congregations. The treasurer is to consult up-to-date resource material on tax requirements and reporting. The treasurer will also consult with a tax preparer and attorney, as necessary.

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APPENDIX

Responsibilities of the congregational treasurer

The responsibilities of the Zion's treasurer are listed in Zion's bylaws Article II Section 7 and in the Treasurer's job description; these responsibilities include but are not limited to the following:

- Serving as financial officer of the congregation
- Being responsible for payment of all bills, invoices, and charges
- Performing or overseeing all the bookkeeping functions
- Preparing the monthly (or quarterly) financial reports for the congregation council
- Filing all the required federal and state tax forms
- Monitoring the cash position of the congregation and investing available funds as directed
- Moving funds as appropriate.
- Providing the congregation with any requested financial information
- Assisting in the preparation of the annual budget for the congregation council

Congregation business ethics and conflict of interest policy

Ethics policies are designed to help people understand fiduciary duties and address conflicts of interest or appearance of conflicts. The policy at Appendix G contemplates coverage for all congregation officers, congregation council members, congregation committee members, and congregation staff. Note that this is called an "operational" ethics policy. The reason for this name is to be clear that Zion has many ethical concerns that are certainly not covered in this short policy. This policy is to address the business side of the congregation and its role as a nonprofit corporation. It is very important that all staff and directors be provided with a copy when it is adopted, and a protocol should be in place to provide a copy to all new individuals.

Separation of financial responsibilities

There will be a clear separation of duties between those responsible for handling and recording the income of the congregation and those responsible for handling the disbursements of the congregation. A strong system of internal controls safeguards the assets of the congregation and protects the character of the individuals handling cash or writing checks. The congregation will operate under the same standards and safeguards as a good business operation. This includes written policies and procedures for key responsibilities.

Employee dishonesty bond

All individuals elected or appointed to handle money in the congregation and its auxiliaries will be covered under an employee dishonesty blanket bond. Further information on employee dishonest blanket bonds can be provided by the ELCA Endorsed Property and Liability Insurance Program.

Handling congregational income

Normal handling of funds in the congregation involves several steps. Some general principles:

1. No individual will be required or allowed to handle the congregation's income alone at any time.
2. Several people will be involved on a rotating basis in handling income.
3. All income transactions (receipts and disbursements) will be properly recorded and verifiable.
4. It is understood that the recording of income or gifts from individuals of the congregation is a confidential matter, and such records are only available to the pastor, financial secretary, and the Treasurer, when required.
5. The pastor may not serve in the position of treasurer and does not have check-signing authority over any church account.
6. All funds under the direction of the congregational council will be in a single checking account and investment program. Zion’s auxiliaries and organizations may be included in this system, authorizing disbursement of funds through the congregational treasurer with vouchers for payment.
7. Financial reports to the council and the congregation will include all funds, accounts and investments of the congregation and its auxiliaries and organizations. No information will be withheld. These will be reviewed and reported on a consistent basis.

Steps in safeguarding offerings and deposits.

No person will be placed in a position where any suggestion of mishandling of funds must be defended by the word of one person against that of another. Prudent and consistent practices in handling money help maintain a climate of trust and help safeguard church assets. See Appendix C

Steps in handling expenditures.

Zion will have documented policies and procedures in place for handling expenditures. This includes what constitutes appropriate business expense, supporting documentation and approval levels for various transactions. See Appendix C

Bank reconciliations

Bank accounts will be reconciled in a timely manner monthly by a member of the Finance Committee, appointed by the council other than the treasurer or anyone having check-signing authority. This procedure will be reviewed and initialed by a person other than the treasurer.

SPECIAL NOTE: "Dormant" bank accounts will be closed.

Recordkeeping and substantiation rules of the IRS

Generally, taxpayers who itemize may deduct contributions of money or property made to charitable organizations. The IRS has special rules on recordkeeping and substantiation of donations received.

Effective Jan. 1, 2007, the IRS requires that all taxpayers who itemize deductions on their income tax returns substantiate their contributions by a bank record (such as a cancelled check) or written communication from the charity (such as a receipt or acknowledgment letter) for all cash contributions. Zion’s acknowledgement must include the name of the charity, the date of the contribution and the amount of the contribution.

Substantiation of single contributions of $250 or more

The requirement that a contribution (cash or property) of $250 or more must be substantiated by a written receipt (as specified below) is unchanged.

Zion is required to acknowledge cash gifts from identified donors by providing a quarterly or annual statement of giving. The statement will include the name of the church, the date, and the amount of each contribution. For single contributions of $250 or more, the statement must:

- Be in writing.
- Identify the donor by name.
- Describe donations of property but not state the value of the property.
- Show separately each individual contribution of $250 or more.
- State whether the charitable organization provided any goods or services to the donor in exchange for the donation, and if so, include an estimate of the value of those goods and services.
- Contain a statement to the effect that “No goods or services were provided to you by the church in connection with any contribution, or their value was insignificant or consisted entirely of intangible religious benefits” if the church provided no goods or services to the donor in exchange for a contribution.

- Provide the receipt to the donor on or before the date the donor files a tax return claiming the deduction.

Quid pro quo contributions of more than $75

A *quid pro quo* contribution is one that is made by a donor in exchange for goods or services. In some cases, contributions may include a *quid pro quo* contribution and a true contribution, e.g., a ticket for an event that includes a meal. The church organization must provide a written statement to a donor for any payments over $75 when the payment is partly a contribution and partly in exchange for goods or services. This written statement should:

- inform the donor that the amount of the contribution that is deductible for federal income tax purposes is limited to the excess of the money contributed by the donor over the value of any goods or services provided by the charitable organization, and
- provide the donor with a good faith estimate of the value of goods or services furnished by the charitable organization.

The IRS has a detailed document called “Tax Guide for Churches and Religious Organizations” that provides further information. It can be accessed at www.irs.gov/pub/irs-pdf/p1828.pdf.

Setting financial goals — the budget

The budget of a congregation establishes the financial goals and overall objectives for the current year and constitutes a good internal control system. The budget is a plan for revenue and expenditures to support activities the congregation has decided to undertake to fulfill the goals of the congregation.

Estimating revenue and expenditure is an inexact science; information from previous years can be a good starting point but should not be the only pre-determining factor for the proposed budget.

Many people do not understand that although something is budgeted, there may not be cash flow to make the expenditure, –It’s the same as having checks, but no money in the bank. Cash Flow is Important, and a well thought out budget can make that happen.

Budget Categories

- Income –Tithe/Offering –Investment Earnings –Rental –Leases –Program / Seminars –Use of facilities (etc.)
- Expense –Salaries –Property/Facilities –Programs –Worship –Missions –Numerous (etc.)

Expenses unplanned

- Churches are labor intensive. Large churches hire professionals to lead and train volunteers to serve the increasing needs of an expanding populace. But if you examine the average church budget, there is little allocated to the development of Bible study leaders, lay leaders and lay and professional administrative leaders.
- These are the people who are on the front lines of providing quality and excellence to attendees who must be assimilated to become contributors.
- Corporations invest 10 percent of their budgets each year in the training of leaders and others who interface with customers. This is a practice that the Zion should incorporate as well.

Likewise, Zion should allocate 5 percent of their annual budgets to promotional activities, including broad and specific target direct mailings, billboard advertising, radio and television infomercials and program sponsorships.

- Frequency and reach are the two words describing the impact of being purchased, and they begin with a good understanding of attendees presently being attracted, especially those indicating their satisfaction by giving more hours and dollars.

Once the budget is established, it is the treasurer's responsibility to report on a monthly or quarterly basis to the council and members of the various committees and ministry teams. This report typically compares actual revenue and expenditures to the budget for the current period and compares revenue and expenditures to the same period from the previous year. Significant deviations from the budget will be highlighted and investigated.

Budget types

The budget type normally used by churches is:

- **Line-item budget:** A line-item budget groups individual items under categories and further lists each item that makes up that category. An advantage of the line-item budget is that it provides a systemic step by step mechanism for formulating the budget, but it should be noted that a listing of every line item is not effective in communicating the plan or mission of the congregation.

Other types of budgets that may be used include:

- **Zero-based budget:** This budget starts at zero, and every item that is presented for inclusion in the budget must be justified as to its need and the benefit it provides. This type of budget typically requires more effort to produce but also forces an in-depth look at every budget line item.
- **Same as last year's budget:** This budget starts with last year's budget and adds percentage increases or makes minor adjustments for the next year. This is the type of budgeting done by most congregations because it is fairly easy to put together. Unfortunately, using a "Same as last year budget" tends to preserve the status quo and can be an obstacle to vision and development.
- **Unified budget:** A unified budget pulls together all the congregation's receipts and disbursements into one budget. Included in this one budget would be anticipated receipts and disbursements from each church group which previously may have had their own budget and even their own bank account. These might include the youth group, the women's group, and the construction budget.
- **Capital budget:** A capital budget provides for the addition of capital items such as office equipment, furniture and fixtures, land, and construction. In the event of a construction project, a capital budget may extend for a period of longer than one year. It normally is developed for the life of the project.
- **Program budget:** A program budget is a way of presenting the budget that puts all expenditures into various program categories, e.g., worship, learning, outreach, etc. Salaries can also be prorated into each program category. A program budget can be an effective communication and planning tool. It can show ministry emphasis more clearly than a line-item budget. A program budget displays the budget in such a way that it becomes readily apparent to all where the resources of the congregation are devoted in its efforts to carry out the mission of the church.
- **Line-item budget:** A line-item budget groups individual items under categories and further lists each item that makes up that category. An advantage of the line-item budget is that it provides a systemic step by step mechanism for formulating

the budget, but it should be noted that a listing of every line item is not effective in communicating the plan or mission of the congregation.

- **Debt-retirement budget:** A debt-retirement budget is a special budget that lists all the funds and use of these funds needed to pay off indebtedness.

The budget type normally used by Zion is the ‘Line-item budget’. This budget starts with last year’s budget and adds percentage increases or makes minor adjustments for the next year.

Financial reporting

Once the annual budget for the congregation has been approved and the various accounts of the accounting system (chart of accounts) have been established, the financial structure of the congregation is in place. The treasurer must now transform these data into meaningful reports so that the financial status of the congregation can be monitored, and decisions made.

The Church Council has legal responsibility for financial integrity, but Council members are not the accountants, so don’t inundate the board with pages of detailed accounting records and then wonder why the Council can’t see the “big picture.” Boards need analysis and interpretation more than they need the numbers. There is no one-size-fits-all financial report. Reports must be designed to communicate information specific to the organization’s size, complexity, and program structure in a format that matches the knowledge level and role of board members.

The format and content of reports for the Council should be determined by their intended purpose. The Council actually uses financial information for four distinct purposes: compliance with financial standards, evaluation of effectiveness, planning, and immediate action.

Compliance. Most nonprofits do pretty well with providing the board with financial reports that comply with the board’s legal fiduciary role to know how much the organization has received and expended. Historical financial reports, audits, and 990s are the common reports.

Evaluation. For the Church Council to evaluate how well the organization has used financial resources, different information is needed. Comparisons are needed to measure progress toward goals, assess the financial aspect of programs, and consider financial strategies.

Planning. When the Council is engaged in planning to project future needs and changes or to develop budget guidelines, they need a big picture understanding of the organization's history and of the external environment and financial drivers.

Taking Action. Sometimes the Council needs to make a key financial decision to implement a strategic plan, react to a sudden change, or respond to an opportunity. In order to make a wise but timely decision, the Council needs to understand the background and situation and scenarios based on one or two possible actions. And form should follow function: before developing financial reports for the Church Council, ask what type of actions or decisions the Council will need to make, and provide them with the right amount of information and analysis in a format that fits the purpose. Don't ask your Council to maintain a top-level focus on strategy while submitting financial reports better suited to the auditors.

All expenses are recorded at the lowest level of activity defined. Reports are then created that can roll up into the level above it. If properly established using account codes in the church's accounting system, this hierarchy allows the directors of the programs to better manage their programs by being able to record expenses at the proper level, thus keeping control of how expenses relate to each activity. This control allows the directors to better appraise if these expenses are being kept in relationship to the original plans (budget) that were prepared in response to the strategic plans created. It also allows for the church council to view expenses at the level they deem most appropriate in their fiscal oversight role. The accounting system will then be able to give reports at whichever level the reader wants.

- At a minimum, the financial statements should consist of a **balance sheet** (also called a statement of financial position) and **statement of revenue** and expenses (also called a statement of activities). A statement of changes in cash flows is also very desirable.
- The financial statements should be designed to meet the needs of the user.
- Financial reports should be prepared on a timely basis.
- The format should be simple and easily understood.
- The reports should be all inclusive.
- The reports should have a point of comparison, such as comparison to budget or comparison to last year.
- Reports should provide the needed detail for decision making.
- The treasurer should include a verbal or written report which points out critical items and areas.

The term ‘object’ is often used to describe the distinctions between various types of income and expense (also used for balance sheet items). Objects describe how the work described in programs and activities is accomplished. Typical examples of objects on the expense side might be:

- Salaries
- FICA taxes
- Federal withholding
- Housing allowance
- Books
- Utilities (most likely broken down further by specific type of utility)
- Travel
- Music purchases
- Repairs

Typical examples of object on the income side might be:

- Unrestricted member giving
- Restricted member giving: pass-through (perhaps broken-out by types of restriction, such as food pantry; locally supported institution, etc.)
- Building fund
- Space rental (often broken out by major types of rentals, such as weddings, local outside organization that rents on a regular basis)

The list of potential objects is endless. Care should be made to capture the proper list of objects required to manage the congregation. Do not create a list so extensive that there are thousands of objects not really needed. On the other hand, don’t make the list of objects so short that it does not provide guidance in how resources are received or spent. It’s a fine line that should be sufficiently thought through in order to provide information at the level wanted and required. Again, almost any financial software comes with a list of regularly used objects (they may use other terms) that allow for addition or subtraction as you see fit. They will also allow the creation of reports at the object level. This becomes valuable in analyzing the congregation’s income and expenses across programs.

The combined use of cost centers and objects will then allow budgeting and reporting on the church’s budget plans in many and various ways. Reports can be prepared that cut across the congregation in either direction: program or object. Keep in mind that no report will satisfy everyone. It must be possible to create reports that depict the activity of the congregation in many ways! Programs and types of income or expense are the most obvious.

The report that looks only at types of income and expense but fails to report at the program level unwittingly condenses the mission of the congregation into units of measure that have no relationship to the depth and breadth of God's work. Conversely, reports that show only the program level, while more clearly describing God's work, fail to explain how that work is done. This dilemma is what has led programmatic budgeting presentations to become such a valuable way of presenting the work of congregations in a way that attempts to become a true financial expression of the work and mission.

Budget Presentations

A program budget presentation is usually used when describing a presentation that combines:

- Presenting the budget by program
- Describing what is accomplished in those programs

A programmatic budget presentation should probably be at least two pages but no more than four pages long. The number of major programs, of course, is the determinant factor.

Just one way to present a budget is usually insufficient. A subsequent presentation of line items (detailed listing of income and expense objects) is usually an acceptable second option of presenting the budget.

When the list of programs, their description and their budgets is developed, the congregation has a comprehensive list of who they are and what they do. This report should be reviewed and examined by asking the questions, "Does this accurately represent what we do?" and "Does this description align with stated strategic plans of who we say we want to become?" If the answer is not a resounding "Yes" to both questions, something is wrong. Either the programmatic budget was not accurately prepared or there are still holes in accomplishing the strategic plan. If it is the latter, this should be acknowledged in the presentation.

How to Deal with Staffing Issues

How staffing and their compensation are decided to be included must be carefully considered. Zion requires that all salaries are openly disclosed, therefore, this issue is diminished. All staff must be aware of the congregation's practice and philosophical approach when they are hired.

Program Descriptions to Avoid

While all actual programs of a congregation should be depicted, there are a few that are buzz words that should be avoided unless they are clearly defined.

The most egregious descriptions that can never find the same definition by two people are the words “administration” and “overhead’. People use these words to describe expenses they believe are irrelevant or, at best, minor aspects of an institution’s programs. First Corinthians 12:4-6 makes the opposite point. Try running a congregation without sufficient administrative or custodial staff and you quickly find the congregation just doesn’t function well. Take time to clearly define similar programs. Be sure to describe support functions in a manner that lifts them up as important and vital aspects of the total ministry.

A Narrative budget presentation:

- integrates dollars, people, and ministry to tell the story of congregation’s mission and ministry. It is the representation of the line-item budget in simple, easy-to-read descriptive terms, often with congregational pictures, quotes, illustrations, graphs, and pie charts; however, it does not replace the financial statements.
- is developed by the treasurer and/or finance committee, presented in PowerPoint at the annual congregational meeting and distributed as a printed resource.
- gives a vision of ministry rather than just a spreadsheet of line items. It reflects how the congregation spends its time, talent, and treasure in a different way, rather than just how we pay the bills.
- can assist with stewardship conversations. It helps focus stewardship on the core message of celebrating God’s gifts to us, and every member’s opportunity and obligation to celebrate and offer in return their gifts to God.

Budget contingency planning

It is both prudent and strategic to develop contingency plans as part of the budget development process. Because a large percentage of a congregation's operating budget is from weekly offerings, small variances in the percentage of income shared or the number of households giving can have a significant impact on a congregation's budget plan. A guide for budget contingency planning can be found at Appendix B:

The accounting system

The congregations will utilize a double-entry accounting system where debits equal credits for every entry made. The accrual method provides a more accurate record of an organization's financial picture and conforms with General Accepted Accounting Principles (GAAP).

Fund accounting systems

Fund accounting separates assets into net asset classes based on whether there are any restrictions on the funds. Assets may be unrestricted, temporarily restricted and permanently restricted. Zion also has designated funds. These are designated to a certain purpose or project based on council action. (Designated funds may be treated separately as a fund in internal record-keeping but are considered unrestricted for accounting purposes.) Temporarily restricted funds are those that have a purpose or time restriction. Permanently restricted funds are typically endowments. Each fund is a self-balancing group of accounts that records assets, liabilities, and fund balance as well as revenues and expenses.

The funds used by congregations include General operating fund (unrestricted); Temporarily restricted funds (purpose restriction or time restriction); Property, plant, and equipment funds (unrestricted); Permanently restricted funds (e.g., endowment funds); Designated funds (unrestricted)

- **General operating fund:** The treasurer must be aware of any separate bank accounts and separate banking institutions for these various funds. The treasurer must review each separate account to be certain that the bank resolutions and associated signature cards are current and safeguard the interests of the congregation. The general operating fund handles all the business activity of operating the congregation.
- **Temporarily restricted funds:** Temporarily restricted funds are those that come from donors with the specification that the gift be used for a particular purpose or there is a time restriction on them. Restricted funds can range from a Flower Supply Fund to a Dishwasher Fund to a New Carpet Fund. An individual makes a gift expecting it to be used for a specific item or program. These restricted funds are temporarily restricted until the intended purpose, or the time restriction has been met, after which they are released from restriction.
- **Property, plant, and equipment funds:** The congregation records the cost of their fixed assets in a separate fund. This practice is helpful for keeping track of capital items for insurance purposes as well as for historical cost and depreciation purposes.

- **Permanently restricted funds:** A permanently restricted fund is typically a gift for which the donor has stipulated that the principal is to be maintained in perpetuity. The donor may also stipulate that the income from the investment activity may be expended for specific purposes such as scholarships. Endowment funds are a notable example of permanently restricted funds.
- **Designated funds:** Also called quasi-endowments, board-designated funds are those funds which the council or other governing body, rather than the donor, has determined are to be retained and invested. The council has the right to decide at any time to expend the principal of these funds. For financial reporting purposes, these funds are classified as unrestricted net assets.

Creating a chart of accounts: The chart of accounts is the coding system that is developed to record all the accounting transactions. It is important that the chart of accounts be flexible enough to allow for future expansion, but also easy to use and understand. A typical chart of accounts uses numeric codes and/or names for the basic account categories based on the following conventions:

1XXXX refers to assets	3XXXX refers to net assets	5XXXX refers to expenses
2XXXX refers to liabilities	4XXXX refers to revenue	

Petty cash accounts: Sizable amounts of cash, if any, will not be kept in the church office. If there are occasions when small cash payments are needed, a petty cash account may be used. Zion does not currently maintain a petty cash account.

Church employment and payroll

Establishing the employer/employee relationship

A congregation typically has a number of individuals whom it pays for services. An important consideration is whether the individuals are employees or self-employed — independent contractors. This determination affects payroll withholding and worker's compensation coverage. The classification of individuals as either employees or self-employed individuals should take place before any payments are written rather than at the end of the year when doing the W-2s and 1099s. (See 3. EMPLOYEE CLASSIFICATION of SOP # 3 Employee policy manual)

The IRS has developed a list of twenty factors that are to be used as guidance in determining whether an individual is an employee under the common law rules. (Revenue Ruling 87-41.)

1. *Instructions* - an individual who must comply with instructions is usually considered an employee.
2. *Training* - if the worker needs training to do the work for which he was hired, it usually indicates that he is an employee.
3. *Integration* - if the worker’s services are an integral part of the operation of the organization, this generally shows that the individual is an employee.
4. *Services rendered personally* - if the individual must personally do the services, this suggests classification as an employee. A self-employed individual generally has the right to hire a substitute.
5. *Hiring, supervising, and paying assistants by the employer* - normally means that all the workers are employees. A self-employed individual would hire, supervise, and pay their assistants.
6. *Continuing relationship* - the existence of a continuing relationship between an individual and the organization for which the individual performs services is a factor tending to indicate the existence of an employer-employee relationship.
7. *Set hours of work* - means the individual is an employee. A self-employed individual sets his own hours.
8. *Full-time required* - the worker is generally an employee. Self-employed individuals can choose when and for whom to work.
9. *Doing work on employer’s premises* - indicates that the worker is an employee.
10. *Order or sequence of work* - if the organization sets the sequence of work for the worker; this generally indicates that the worker is an employee.
11. *Oral or written reports* - if the worker is required to submit oral or written reports; this suggests that the worker is an employee.
12. *Payment by hour, week, month* - an employee is normally paid by the hour, week or month, whereas a self-employed person is usually paid by the job.
13. *Payment of business expenses* - if the employer pays the worker’s business or travel expenses, this usually suggests that the worker is an employee. A self-employed individual generally takes care of their own business and travel expenses.
14. *Furnishing of tools and materials* - Self-employed individuals generally furnish their own tools and materials. If provided by the employer, then the worker is generally an employee.
15. *Significant investment* - if the employer furnishes all the necessary equipment and premises, this suggests that the worker is an employee.
16. *Realization of profit or loss* - employees do not realize profits or losses from the services they perform, whereas self-employed individuals may.

17. *Working for more than one firm at a time* - an employee typically works for only one firm. A self-employed person typically works for a number of organizations at the same time.
18. *Making services available to the public* - workers who make their services available to the public are normally considered self-employed.
19. *Right to discharge* - the right to discharge is generally a right of the employer and indicates that the worker is an employee. Self-employed individuals usually cannot be fired if they are producing the results specified in their contract.
20. *Right to terminate* - an employee can normally leave the employer at any time whereas a self-employed person, on the other hand, is usually legally obligated to complete the contracted job.

A couple of recent court cases involving employment status highlighted the following seven factors:

1. The degree of control exercised by the employer over the details of the work.
2. The party which invested in the facilities used for the work.
3. The opportunity for the individual to make a profit or loss.
4. Whether or not the employer has the right to discharge the individual.
5. Whether the work is part of the employer's regular business.
6. The permanency of the relationship.
7. The relationship the parties believe they are creating.

Employees (other than clergy)
Typically, most of the workers that congregations hire fall into the category of employee other than clergy. This can include associates in the ministry, secretaries, office staff, choir directors and janitors. These individuals typically do not meet the requirements for being considered self-employed.

For tax purposes, non-clergy employees of tax-exempt organizations such as congregations are treated the same as employees of any other business apart from unemployment benefits and some tax-deferred savings plans. For the congregation, this means that they are required to withhold the correct amounts of federal income tax, any applicable state tax, and Social Security tax from the employees' wages. They also need to match the amount of Social Security tax from their own funds. IRS Circular E states that once an employee reaches $100.00 in wages, he is subject to FICA (Social Security) withholding. The congregation, as the employer, is required to make timely deposits of these taxes, file Form 941 every quarter, issue a W-2 to each employee at year-end and transmit the W-3 transmittal statement to the IRS along with copies of the W-2s.

Clergy

One of the most difficult concepts to understand is the employment status of ordained clergy. Ordained ministers have "dual status treatment" under the provisions of the Internal Revenue Code.

1. Ordained ministers may generally be treated as employees for income tax purposes (Revenue rule 80-110), but the IRS code exempts ordained ministers from federal income tax withholding (Code section 3401 (a)).
2. Ordained ministers are treated as self-employed for Social Security reporting purposes.

While some clergy consider themselves self-employed, IRS Publication 517 states that in most cases, ordained clergy are considered to be employees of the congregation. Page 4 reads as follows:

Employment status for other tax purposes. Even though all income from performing ministerial services is subject to self-employment tax for social security tax purposes, A pastor may be an employee for income tax or retirement plan purposes in performing those same services. For income tax or retirement plan purposes, income earned as an employee will be considered wages. Common law rules – Under the common law rules, clergy are considered an employee or a self-employed person depending on all the facts and circumstances. Generally, clergy are employees if your employer has the legal right to control both what they do and how they do it, even if they have considerable discretion and freedom of action.

For example, a congregation hires and pays a pastor a salary to perform ministerial services subject to its control. Under common law rules, the pastor is an employee of the congregation while performing those services.

A couple of other factors strongly suggest that pastors are indeed employees of the congregation.

- Employer-paid pension benefits
- Employer-paid medical benefits
- Worker’s Compensation Insurance coverage

A self-employed contract laborer would be ineligible for the benefits listed. If the pastor receives the above benefits, the IRS will most probably categorize him/her as an employee and advise that he/she should be getting a W-2 at the end of the calendar year.

The consequences of classifying someone as an independent contractor instead of an employee could include penalties and interest, back payment of the employees FICA payments and all taxes that should have been withheld.

Self-employed independent contractors

If after a thorough evaluation, the congregation deems that certain individuals whom they pay for services are indeed not employees, then they are considered self-employed or independent contractors.

There are no tax consequences to the congregation for hiring independent contractors. That is, there is no withholding, no quarterly filing, or no remitting of taxes on behalf of such individuals. There is one important year-end filing requirement. The IRS requires that Form 1099-MISC be prepared and given to the worker if the individual received more than $600 during the year. Form 1096 is also prepared and sent to the IRS with the number of 1099s issued and the total dollar amount.

Whenever the congregation has contract work done, they should require the contractor to complete an IRS form W-9 so that the congregation can secure the Social Security number of this individual.

Also, if the independent contractor is in the business of supplying its services to the public and advertises such services, it would be appropriate for the congregation to request a "Certificate of Insurance" from the contractor naming the congregation as "Additional Insured" on the contractor’s insurance policy. This would indicate to the congregation that the contractor has liability and Worker’s Compensation Insurance in place for this project.

Housing allowance

The allocation of housing to those eligible individuals employed by the congregation is a matter that should be reviewed by those individuals and the congregation council. The treasurer should be given written instructions as to the amount that will be designated as a "housing allowance" for each person authorized to participate in this allowance.

A tax advantage available to clergy is the ability to exclude from federally taxable income the rental value of a parsonage or that part of compensation that is used to provide a home. (Internal Revenue Code section 107)

Who qualifies for the housing allowance?

- Must be employed by the congregation (or agency of the congregation)
- Must be ordained, commissioned, or licensed.
- Administers the sacraments.
- Conducts religious worship.
- Has management responsibilities in the church or denomination.
- Considered to be a religious leader.
- Available to the pastor as compensation for services

All of these need not apply.

What kind of expenses can be used when calculating the housing allowance exclusion?

- Mortgage or rent payments.
- Real estate taxes
- Property insurance
- Down payment on a home
- Utilities
- Furnishings & appliances (purchase & repair)
- Remodeling & repairs
- Yard maintenance & improvements

How much of the pastor's salary can be used as the housing exclusion?

Only the lowest of the following can be used when the pastor files his/her federal income tax return:

- The fair rental value of the home
- The amount actually used to provide a home.
- The amount officially designated as the housing allowance.

How is the difference between the designated housing allowance and the lower of the three amounts handled?

- If the allowance exceeds the lower of the actual expenditures or the fair rental value, the pastor needs to include the difference on Form 1040 as "other income."
- If the actual expenditures or fair rental value exceed the allowance, the difference cannot be taken as an additional deduction on the pastor's tax return. It is lost.
- Clergy need to maintain records supporting the actual housing costs incurred.

How is the housing allowance declared?

- The council or congregation must adopt it.
- It must be in writing.
- It must be in advance of the calendar year or in advance of a new pastor starting employment. (If a congregation fails to designate an allowance in advance of a calendar year, it should do so as soon as possible in the new year. The allowance will operate prospectively, never retroactively.)

What about the pastor living in a parsonage?

Those clergy living in congregation-owned parsonages are already having the fair rental value of their home excluded from their income. In addition, they can request their council to establish a "parsonage allowance" out of their salary that is used for such things as utilities, repairs, and furnishings for the parsonage.

What is a housing equity allowance?

A housing equity allowance is used by forward-thinking congregations to deal with the situation where a pastor has spent his/her career in congregations with parsonages and has been prevented from building up equity in a home that is normal for pastors who are able to own their own home. Because parsonages are provided more for the economic benefit and convenience of the congregation than for that of the pastor, the equity allowance is an appropriate response to the situation by the congregation. This is best accomplished by providing the allowance in the form of a tax-sheltered annuity. This limits the tax burden on the pastor and helps ensure that the funds are not available until retirement. Please contact Portico Benefit Services for more information.

How is the housing allowance handled on the W-2?

The housing allowance (or the value of living in a congregation-owned parsonage) is always excluded from federal income. This means the treasurer excludes this value from Box 1 of the W-2. The treasurer can, however, put this amount in Box 14 of the W-2 which is merely an information box.

Payroll tax obligations

Every congregation must report the income paid to each employee to the Internal Revenue Service. Zion currently contracts out this activity to a Certified Public Accountant. These steps will prepare you to meet this obligation.

1. Employer Identification Number (EIN). Every congregation should have an EIN. To secure an EIN, the congregation must complete Form SS-4, Application for Employer Identification Number, available from the Internal Revenue Service. Once you are assigned a number, the congregation should automatically begin receiving:

    - Form 941, Employer's Quarterly Federal Tax Return
    - Form 8109, Federal Tax Deposit Form
    - IRS Publication 15, Circular E - Employer's Tax Guide

2. Determine whether each worker is an employee or self-employed. In most cases, individuals who perform services for a congregation are considered employees of the congregation. If in doubt, congregations should treat workers as employees since penalties can be assessed against a congregation for treating a worker as self-employed if the IRS later reclassifies that person as an employee.
3. Have each employee complete a W-4 Form, and have each self-employed individual complete a W-9 Form. The W-4 Form for employees gives the congregation the necessary social security number, address of the employee and the information required to withhold the correct amount of federal income tax. (Any W-4 forms which claim more than ten withholding allowances need to be reported to the IRS.) The W-9 Form for self-employed individuals provides the congregation with addresses and social security numbers of the individuals. This information is needed when filing 1099s for these individuals at year-end. (If a self-employed worker performs services for your congregation and earns at least $600 for the year but fails to provide you with his/her social security number, then the congregation is required by law to withhold 28 percent of the amount of compensation as "backup withholding.")
4. Compute each employee's taxable wages. Each employee's taxable wages include the following:

    - Cash Christmas gifts from the congregation.
    - Social Security offsets given to any clergy employees.

- Imputed interest on low-interest (or no-interest) loans that the congregation might make to any employee.
- Personal use of a church-owned vehicle
- Any business expense reimbursement given under a non-accountable business expense reimbursement arrangement. For example: a car allowance is given to an employee every month, but the congregation requires no record keeping or accounting for how the car allowance was spent. The total given as car allowance is considered taxable wage and at year end would be included on the W-2.
- Bonuses or any cash gifts
- Forgiven debts.
- Most reimbursements of a spouse's travel expenses.

The following amounts can be **excluded** from taxable wages:

- Payments to a compliant Flexible Spending plan
- Voluntary pension payments made to a 403B plan. However, such payments are subject to social security tax.

5. Determine the amount of income tax to withhold. IRS Publication 15 (Circular E) gives you two ways to calculate the correct amount of income tax to withhold. One way is called the wage bracket method in which you use the withholding tables in Publication 15. The other way is the percentage method in which the number of allowances claimed by the employee is multiplied by an appropriate value given in Publication 15. Make sure to secure a new Publication 15 each year to get the most up-to-date withholding tables and percentages.

   Normally federal income taxes are withheld only on the wages of the non-clergy staff. Clergy are exempt from withholding. A clergy member can, however, ask to have federal income taxes withheld (but not FICA). To do this, a clergy member needs to fill out the W-4 giving you a certain dollar amount that he/she would like to have withheld.

6. Withhold FICA taxes from non-clergy employees' wages. Congregations must withhold 7.65 percent of each employee's wages and also match this amount with their own funds. This 7.65 percent rate is composed of two items:
   (1) a Medicare hospital insurance tax of 1.45 percent on all taxable wages and
   (2) an "old-age, survivor and disability" tax of 6.2 percent.
   Refer to your current year's tax guide to determine what the maximum taxable wage is for this category.
7. The congregation must deposit the taxes it withholds. There are three components of federal payroll taxes:

a. federal income taxes withheld from the employees' wages,
b. the employees' share of FICA taxes, and
c. the employer's share of FICA taxes.

These dollars must be deposited according to the deposit status that the IRS determines for each congregation. In November of each year, the IRS notifies every employer of their deposit status for the next year. The different rules are as follows:

- If withheld taxes are less than $2,500 at the end of any calendar quarter, the congregation may not need to deposit the taxes, but rather send them directly to the IRS with each quarterly 941 Form.
- If withheld taxes were $50,000 or less during the most recent look-back period, the taxes are deposited monthly, by the 15th day of the following month.
- If withheld taxes were more than $50,000 during the most recent look-back period, the taxes are deposited semi-weekly. This means that for paydays falling on Wednesday, Thursday or Friday, the payroll taxes must be deposited on or by the following Wednesday. For paydays on Monday or Tuesday the taxes must be deposited on the Friday following the payday.
- Withheld taxes of $100,000 or more must be deposited by the next banking day.

Generally, all federal tax deposits must be made using electronic funds transfer. The Electronic Federal Tax Payment System (EFTPS) is a free service provided by the U.S. Department of Treasury for this purpose.

8. All employers subject to income tax withholding, social security taxes or both must file Form 941 each quarter. Form 941 reports the amount of FICA taxes and the withheld income taxes that are payable. This total amount of tax should agree to the amount deposited or accumulated for that quarter. Form 941 is due by the last day of the month following the end of each calendar quarter.
9. Prepare a W-2 form for each employee as well as the accompanying W-3 transmittal form for the IRS. The W-2s are due to employees by January 31; the W-3 is due to the IRS by February 28. Complete the W-2 according to the form's instructions:

Employee out-of-pocket expenses

Generally, reimbursements for out-of-pocket expenses are considered taxable income unless they are made under an **accountable** plan as defined by the IRS and documented under IRS regulations. An accountable plan is one which meets the three requirements below:

- Employees' expenses must have a business connection — that is, they must have paid or incurred deductible expenses while performing services as an employee of your employer.
- Employees must adequately account to their employer for these expenses within a reasonable period of time (60 days).
- Employees must return any excess reimbursement or allowance within a reasonable period of time (120 days).

For more information, please consult IRS Publication 463.

Benevolence remittance to synod and churchwide

Just as members of each congregation share their resources with their congregation, so too each congregation is invited to share with their synod and the churchwide organization.

Statements

Every April 30, July 31, October 31, and January 31, which are the ends of each quarter of the fiscal year, statements are sent out to each congregation. These statements are not a request from the synod office for more funds, but rather opportunities for the congregation to double-check the accuracy of the recording of the monies that had been remitted to the synod. The church is asked to review these statements and contact the appropriate synod office if there is a discrepancy of any sort.

Where to send

All benevolence checks should be made out in the name of the synod and sent to the synod's address. Please remember that it helps the cash flow of the synod to receive funds on a timely basis.

Undesignated gifts

The undesignated gifts that are sent to the synod office are made up of two components:

1. that part which stays with your synod and goes toward the support of its synodical ministries; and

2. that part which gets forwarded to the churchwide organization and supports national and global ministries.

The percentage that gets forwarded on to the churchwide organization ranges from 40 percent to 55 percent and is determined annually by a consultation between each synod and churchwide staff.

Restricted gifts

Restricted gifts are those gifts that are intended for very specific purposes rather than for general support of the synod and churchwide bodies.

Any gifts for specific local purposes such as those to local nursing homes, food banks, etc., should not be sent to the synod office but rather handled by the congregation directly.

The synod office can take any purpose-restricted gifts for special projects going on in each individual synod. The other types of restricted gifts that the synod office can process are those that need to be forwarded to the churchwide organization. These would include gifts for purposes such as ELCA World Hunger, ELCA Malaria Campaign, Fund for Leaders or Lutheran Disaster Response as well as missionary sponsorship or other projects for which the churchwide organization is collecting funds.

Each recipient of such a gift also receives a listing informing them of who provided the gift and the amount from each giver.

Using the remittance form

Please use the remittance form that is provided from the synod office to send in benevolence. The form makes it easier for the office to process and provides the office with documentation after the check has been deposited.

The Synod office will provide the forms. Line No.1 is for the undesignated benevolence – that is the money that gets split between the synod and the churchwide organization. The remaining lines are for any possible purpose-restricted gifts. Be as clear and descriptive as possible when using the lines of the form to list those gifts. Please total the gifts and make sure your remittance form equals the amount of the check you include.

What is an audit?

Generally, an audit is comprised of a number of tests of the various transactions that occurred during the year. These tests, along with questions and inquiries made by the auditor(s), lead to an opinion about the appropriateness of the financial statements.

Why have an audit?

- To obtain independent assurance that all financial records fairly represent the financial condition of the congregation.
- To ensure that the year's financial activity has been properly recorded in accordance with generally accepted accounting principles.
- To ensure adherence with the policies and procedures established by the congregation; and
- To maintain confidence in the integrity of the congregation's financial system and the individuals responsible for handling the finances.

ELCA's recommendation regarding congregational audits

The churchwide organization of the ELCA does not require that congregations have an audit performed every year, but it highly recommends the practice. There is no stipulation concerning who should perform the audit — an outside audit firm, the congregation's audit committee or an individual congregant(s) with a financial background appointed by the audit committee or council. At a minimum, the council should appoint an audit committee and have this committee (or an individual congregant(s) working under the guidance of the audit committee) review the congregation's financial records each year. An audit can often discover weaknesses in the congregation's system of internal controls or discrepancies in the financial records. Having an outside auditor from a certified public accounting firm conduct periodic audits can be beneficial in providing an independent assessment of the congregation's financial management process.

The audit committee

The council of the congregation appoints the audit committee. This committee should be composed of at least two members of the congregation, excluding the treasurer and the financial secretary. It is preferable that they be individuals who have had training in accounting procedures.

The committee, with the approval of the finance committee, may secure outside help on a fee basis from an independent accountant, registered in the state.

Functions of the audit committee

- Examines and reviews all financial statements.
- Conducts the annual audit or exercises supervision and oversees the work of the audit if an outside accounting firm or individual congregants conduct it.
- Examines all insurance policies and prepares a schedule of the insurance coverage.
- Inspects and examines securities and investments.
- Prepares a schedule of the securities and investments for review by the finance committee.
- Reports its findings in writing to the council with supporting schedules and recommendations for change and improvement.
- Verifies that the congregation complies with federal and state tax laws and regulations.

Insurance coverage

The council (and/or the finance committee) has the responsibility to secure adequate insurance coverage to safeguard the assets of the congregation. Fires and thefts happen on occasion, and it is crucial that each congregation protect itself and review its policies on an annual basis. For further information check the ELCA Endorsed Property and Liability Insurance Program.

References

Complete Handbook of Church Accounting, Holck, Manfred, Prentice Hall, Inc.

Church Bytes Software Guide, Church Bytes, Inc., 562 Brightleaf Square #9, 905 West Main Street, Dunham, NC 27702, (919) 479-5242

Portico Benefit Services has a website at https://www.porticobenefits.org, which has many valuable tools for congregational treasurers and bookkeepers.

The IRS has released some new publications that may be of interest to you — they can be found in the publications link at www.irs.gov.

Publication 4221-PC, *Compliance Guide for 501(c)(3) Tax-Exempt Organization*. This brochure explains disclosure rules, record-keeping, and report-filing rules that apply to 501(c)(3) organizations. www.irs.gov/pub/irs-pdf/p4221pc.pdf
IRS Publication 1828, *Tax Guide for Churches and Religious Organizations* www.irs.gov/pub/irs-pdf/p1828.pdf. This document is a review of many of the IRS provisions, regulations and information that may be of assistance to ELCA congregations and related organizations. Topics include explanation of the Group Ruling and tax exemptions, unrelated business income tax (UBIT), political and lobbying activity prohibitions, rules for withholding for ministers, housing allowances, record and file keeping requirements, substantiation rules as well as special rules limiting the IRS authority to audit a church.

IRS Publication 463, *Travel, Entertainment, Gift and Car Expenses* www.irs.gov/pub/irs-pdf/p463.pdf Publication 463 outlines treatment of various reimbursable business expenses and accountable plans.

Revelations: Church Administration Software, www.revelations.com, (800) 596-4266. Windows and Macintosh compatible.

Resources

The Office of the Treasurer maintains a resource page for congregations at http://www.elca.org/Resources/Financial.

As of September 2013, resources available include:
Congregational Audit Guide Internal Control Best Practices Accountable Reimbursement Policies Financial Contingency Planning Data Security Identity Theft Program Budget Presentations

The resources below can be accessed at: http://www.christianitytoday.com

- *Church Finance Today* (a monthly review of accounting, financial and tax developments affecting ministers and clergy), *subscription service.*
- *Church Law & Tax Report* (a bi-monthly review of legal and tax developments affecting ministers and churches), *subscription service.*
- *Church and Clergy Tax Guide* (resource book for sale, updated annually)
- *Narrative Budgeting, Christian Practice, Purpose and Narrative*, Judith Johnson
- *The Importance of a Narrative Budget* by Dave Ponting

Appendix A: Budget

The Budget Process

A budget is a planning tool that reflects an organization’s programs, mission, and strategic plan. Typically, the budgeting process should begin at least three months before the end of the fiscal year to ensure that the budget is approved by the board of directors (Church Council) before the start of the new year.

An operating budget, also known as a broad scope budget, gives an organization a financial picture of the activities the organization has planned for the coming year. Boards (church council) also use the operating budget to show projections of various amounts of revenue and their sources. Just as it sounds, an operating budget shows how much you intend to spend on operations for the next year.

An operating budget is different than the capital budget, and it plays an important role in budgeting for the church. A capital budget includes projects that have an ongoing impact on your operations. A capital budget is also used to plan for major expenses like construction costs and other big, one-time expenses that take more than a fiscal year to fund. What makes an operating budget different from a capital budget is that it provides a breakdown of your annual projected expenses and revenue according to different funding sources, operating expenses for each program, and your overhead costs.

1. **Determine timeline**

   The Church Council should begin reviewing its budget at least three months before the end of the fiscal year. This is important so that the board will have time to approve the annual budget before the start of the next year. It helps to establish a timeline with a target date for board approval.

   - Set target date for Council approval.
   - Allow time for each step and for review and discussion.
   - Approve before beginning of fiscal year.

2. **Agree on goals**
   - Prioritize program delivery goals.
   - Set organizational financial goals.
   - Clarify annual goals from strategic plan.

3. **Understand current financial status**
   - Review current year income and expense compared to budget.
   - Forecast to the end of the year.
   - Analyze and understand any variances.

4. **Agree on budget approach**
    - Assign roles and responsibilities
    - Agree on authority to make decisions
    - Agree on how much uncertainty can be included (how many unknowns)

5. **Develop draft expense budget**
    - Determine costs (expenses) to reach program goals
    - Determine costs to reach organizational and strategic goals

Timeline

July

- At the first budget planning meeting, the Council or Finance Committee should agree on their financial goals.
- The second meeting of the Finance Committee should focus on developing a draft of an expense budget and an income budget. The committee will need to determine the costs for the upcoming program goals, organizational goals and strategic goals. In determining the income budget, the committee will need to project income based on the current fundraising and revenue activities.
- The June 30th individual account-level statements are printed and distributed to the appropriate staff, chair, council members or lay person.
- A draft income budget is developed: At this point, the Finance Committee should have a draft budget ready and do a thorough review of it. The review should include verifying that the budget is able to meet program and organizational goals. Budget planning includes some degree of forecasting and assumptions and boards should thoroughly vet assumptions before finalizing the budget. They should make any final adjustments based on the organization’s goals and its capacity to match income and expenses as closely as possible. In addition, they should review the final draft against the organization’s goals and objectives.
- Income is projected based on current fundraising and revenue activities.
- New income based on new activities is projected.

August

<u>Budget Preparation</u>:

- The various church committees/ministry teams are made aware of their budget responsibilities and the time frame they have to submit an estimate of their budget to the Finance committee. The committees/teams determine their needs for the upcoming year. The committees/teams forward their budgets to the Finance committee.

- The financial secretary develops an estimate of the next year's income.
- The Treasurer will coordinate finance budget timing with Copastors.
- Budget request forms and cover letter are prepared.

September

Budget Preparation (continued):

- Individual general ledger account-level reports through August 31st are printed.
- budget requests forms, cover letters and general ledger reports are distributed.
- Treasurer starts to update budget spreadsheets.
- A representative from each committee meets with the budget committee to review the budget submitted by that committee. Discussion to keep or remove certain budget items occurs at this time.
- The treasurer meets with the copastors and finance chair – begin preliminary planning for the budget.
- The congregation council appoints an audit committee.
- The Treasurer coordinates with the Finance chair to set a date for the Finance Committee budget meeting – usually the 3rd week of October.

Review draft budget

- Verify that the draft meets program and organizational goals.
- Review and discuss all assumptions.
- Make adjustments, based on goals and capacity, to match income and expenses.
- Review final draft for all goals and objectives.

October

- Budget spreadsheets are completed.
- Spreadsheet drafts are sent draft to copastors and finance chair for preliminary review.
- Necessary revisions are made.
- The second draft of the spreadsheet is sent to Finance Committee prior to budget meetings.

November

- The Finance Committee conducts budget meetings.

<u>Approve budget</u>
- Present to any committees as needed.
- Present to the Church Council for approval.

December

- Read about year-end close in Shepherd's Staff
- Insert a reminder in the December newsletter to input all bills by 12/31...

<u>Budget</u>:
- Update budget for any changes.
- Print/distribute budgets at the council meeting.
- The budget committee compares all the budgets submitted with the anticipated income and prepares a balanced budget which it presents to the congregation council.
- Document budget decisions.
    - Create a consolidated budget spreadsheet and file.
    - Write down all assumptions.

January:

<u>Before the Congregational Meeting:</u>
- The books from the prior year books are closed.
- End of year accounting systems is backed up to flash drive and external drive.
- New salary information and/or new housing information is sent to (*Paycheck*) including catchup adjustments.
- Full-time salaries are updated online in *Portico*. This is necessary to ensure that benefits are calculated correctly.
- Accounts are added/removed/changed as necessary in Shepherd's Staff
- The council reviews the budget and makes any adjustments it deems necessary.

During the Congregational Meeting

- The council presents the budget to the congregation.
- The budget is discussed and approved by the congregation. (If not approved, the budget goes back to Step 6 above for further evaluation and follows the remaining steps.)
- Once approved the budget is entered into Quickbooks/Shepherd's Staff.

After Congregational Meeting:

- A spreadsheet is prepared calculating catchup salary increases (if necessary)

Implement budget

- Assign management responsibilities.
- Incorporate into accounting system.
- Monitor and respond to changes as needed.

Feb

- Prepare ELCA Congregational Report (Due in Feb)
- Complete Personal Property Tax (Due April 15th)

Appendix B: Contingency Planning for Congregations

Why do contingency planning?

It is both prudent and strategic to develop contingency plans as part of the budget development process. Because any number of factors can impact income and because a large percent of a congregation's operating budget is supported by a "single" source (weekly offerings), small variances in the percentage of income from members can have a large impact on the congregation. The most strategic use of resources happens when we are prepared to answer the question of what we would do if the income received deviates significantly from the approved income budget. Decreases in income often need to be addressed more swiftly than increases in income; however, it is best to have a plan for reacting to either scenario.

Budget contingency plans may never be implemented but have the possibility to affect staff, programs, and ministry partners; it is important to think carefully about how and when plans are shared beyond the leadership. Failure to do so can create stress and uncertainty that may have an unintended impact on operations and staff. Attention to staff morale during times of economic uncertainty is vital.

Similar to business continuity plans, budget contingency plans are developed in case they are needed. Some plans will never be used or will only be used partially.

Specific components of contingency planning that are addressed in this document include:

- Operating reserves
- Cash flow projections
- Budget reductions
- Banking relationships

Who does contingency planning?

- Congregation Council
- Staff
- Financial Secretary

OPERATING RESERVES (See Appendix H)

What are operating reserves?

Operating reserves are unrestricted fund balances. They are similar to retained earnings or equity in other businesses. These funds are developed as a result of operating income exceeding operating expense over a period of time. The net operating income from one fiscal year is added to the congregation's operating reserve, while operating at a deficit in a given fiscal year will result in a reduction to the congregation's operating reserve.

Other Kinds of Reserves

There are other kinds of reserve funds that can be established to build up cash balances for specific purposes such as building repair and replacement reserves, program reserves to support program continuation if income is uncertain, and opportunity reserves to allow an organization to provide seed funding for a new idea or innovation. Each type of reserve needs the same kind of planning and policy as described for operating reserves.

How do operating reserves function?

Operating reserves provide a cushion to help an organization survive lean periods and any unexpected events that could deplete funds. Operating reserves can help congregations to:

- Survive operating shortfalls caused by economic conditions or unexpected disruption in cash flow (i.e., several Sundays of inclement weather which subsequently affect weekly offerings);
- Enhance their capacity to develop new programs or discontinue or retool current programs;
- Obtain favorable financing terms; and
- Achieve steady distribution of support for programs and ministries.

What is the appropriate level of operating reserves?

There is no pre-defined answer to this question, but following are a few factors that congregations should take into consideration:

- When income is derived primarily from a predictable, broad-based membership or body of contributors, the level of operating reserves may generally be lower than if income is derived primarily from a few large contributions.

- If cash flow is irregular, operating reserves should generally be higher than if cash receipts are consistent throughout the year. Seasonal swings in income and expenses should be identified and tracked so they can be anticipated.
- If expenses are primarily fixed or predictable, reserves can generally be lower.
- If the congregation owns fixed assets or equipment that is likely to require renewal or replacement, operating reserves may need to be higher. It is advisable to develop a plan so that as fixed assets age, replacement and repairs can be funded.
- Reserves should be higher for congregations with long-term debt, payables, and deferred income since significant liabilities reduce operating flexibility and increase the risk of penalties and interest for late payments.

Most non-profit organizations maintain an operating reserve of approximately 30 percent of their annual operating budget, or enough to cover all expenses if income completely ceased for three to four months. That might be a good place to start the discussion. The portion of Mission Support income remitted to the respective synod and churchwide ministries should be subtracted from operating expenses before calculating the reserves.

CASH FLOW PROJECTIONS

One factor that should be considered when setting the operating reserve level of the congregation is the schedule of cash flows. Projections of receipts and expenditures, which comprise cash flow, are ideally developed as part of the budget process, so that the congregation can anticipate and develop strategies for funding shortages or investing surpluses. A good place to start in developing a schedule of cash flows is to review actual monthly cash flow from the prior year.

How do we develop a schedule of cash flows?

- Estimate how much money will be received each month from each income source.
- receipts by month for the previous three years and analyze giving trends.
- Estimate how much will be spent each month on each line item of the budget.
    - Use the prior year's "checkbook" as a basis for projecting the coming year.
    - Note which expenses occur weekly, monthly, quarterly, etc.\
    - Adjust for any anticipated changes that will affect the timing and number of payments and deposits.

- Add items impacting cash flow that are not listed in the budget, such as accounts receivable or payable from the prior year.
- Update the cash flow projections at least quarterly.

How do we address a temporary cash shortage?

Actions that are often considered to address a temporary cash flow issue include:

- Obtain a loan or arrange for a line of credit from a bank to maintain necessary liquidity and avoid unfavorable timing of investment sales.
- Invite members to make short-term loans to the congregation.
- Expedite the collection of receivables.
- Accelerate any planned special funding appeals.
- Consider equipment leasing arrangements.
- Liquidate investments.
- Renegotiate payment terms with vendors and ministry partners.
- Refinance loans or request deferral of principal payments for several months.
- Consider action to change designation of previously designated funds to meet operating needs.
- Consider canceling temporary employee and agency contracts.
- Consider canceling non-essential purchased services.
- Defer non-essential travel and discourage multiple staff from traveling to the same event; utilize more cost-effective options such as web-conferencing.
- Implement a hiring freeze for new and open positions.
- Freeze approvals of new discretionary grants.
- Freeze new capital expenditure approvals.

Staff can be helpful in making recommendations regarding cash flow and expense timing.

What if the situation is not expected to improve quickly?

If the cash shortage is due to more than temporary cash flow, it must be addressed through raising income or reducing expenses. It is best not to count on new sources of revenue until they are proven to be reliable. The fundamental issues causing the cash flow or deficit need to be addressed during the budget planning process and reductions may have to be considered. It is not advisable to run an operating deficit for successive years.

Budget Reductions

There are several ways that most congregations make cost reductions, some more strategic than others, including:

Across-the-Board Cuts: This method of reducing costs is the easiest to administer. Staff and volunteer program leaders are asked to develop proposals for achieving the cuts in their areas. This gives them the flexibility to make cuts where they will do the least damage to their programs and ministries. The request can include multiple levels of reduction proposals, such as asking for budget reduction proposals at the various levels (e.g., 10 percent, 15 percent, and 20 percent). The disadvantage of this method is that it does not account for differences in the programs' ability to absorb cuts, level of budget flexibility and most importantly, in how strategically aligned the programs are to the congregation's mission.

Targeted Cuts: Targeted reductions are identified by leadership or through a participatory process. Decisions should be consistent with the congregation's core strategies and the interests of key constituencies. Reductions start with funding that is not entirely necessary to maintain programs and services at a minimally acceptable level. Positions that can be held vacant without undue disruption to the congregation's mission and operation are often targeted. A participatory approach may require more cooperation, voluntary sacrifice and objective analysis than can be expected of staff and leaders. It could also involve major restructuring of staff and programs, especially if funding adjustments are expected to continue beyond the current year.

Operations, Process or Technology-Driven Cuts: This method seeks to analyze processes to identify ways to change procedures or apply technology that will reduce the work required. There may be upfront costs of investing in technology, but once processes are changed and technology is installed, positions and other costs can be eliminated or reduced. This strategy may also involve a shift from operating costs to capital costs funded from reserves or special offerings. This might ease pressure on the annual budget but can strain the congregation's cash balances in the short term.

Are there other things to consider when reducing budgets?

Congregations may want to consider the following factors when preparing to reduce their budget:

- The nature of the deficit
    - Is it a cash deficit, an operating deficit or both? Some congregational operating statements include non-cash items such as depreciation. Others do not capitalize and depreciate any fixed assets. While a non-cash deficit is a serious matter because the

    organization is not generating the resources to replenish itself, the negative effects may play out over a longer time frame, allowing it more time to develop a response.
  - How strong are cash balances? Deficits pose a more immediate threat to an organization with low cash balances, leaving it with fewer options to analyze the situation and develop a response.
- Budget development rules
  - Review the congregational constitution and other governing documents and policies that pertain to budget approval and revisions.
- Timeline for achieving the desired results.
  - Does the congregation need to avoid a deficit in the current period, create a balanced budget for next year, or develop a multi-year recovery strategy?
  - Consideration should be given to the level of cash balances, policies, and the impact of operating at a deficit on the congregation's and members' confidence in the congregation's management.
  - Assess whether current obligations and commitments are being met. If not, an immediate response is required.
- Risk of failure
  - Some strategies for cutting budgets carry more risk than others. In some cases, projected cost-savings may not outweigh the investments required to improve business processes. As such, disruption of services due to restructuring may occur and projected increases in revenue may not materialize.
- Impact on related ministry partners
  - Assess the ways in which reductions would influence relations and the viability of other partners and programs.
- Quality of information
  - Understand the sources of the deficits and costs well enough to identify areas which might be better places to cut, or which can be restructured through process and technology changes. Analyze the connection between program costs and the impact on achieving the congregation's mission and goals.

Communicating budget cuts

It is important to develop a plan for how to communicate budget reduction proposals to staff members, ministry partners and other stakeholders. The communication plan should identify the audiences for communications, the particular information they should receive, and the timing and means for communicating. Here are a few points to consider:

- Speak to the reasons for taking action and about the process leading to a proposal.
- Determine the appropriate tone and level of urgency that will be communicated. Consider whether it is a situation in which everyone needs to pay full attention to the problem and focus on a solution or if people need to simply be cognizant of the issue and have the confidence that it is being addressed.
- Assume that everyone wants to know how it will impact them personally. Keep the message clear. Nuanced language is often misunderstood or missed in situations where they may be personally affected, so communicate clearly and specifically.
- Be attentive and cautious about what is promised and deliver on those promises.
- Do not expect to achieve 100 percent consensus or support for the plan.

BANKING RELATIONSHIPS

During periods of economic downturn or when an organization experiences a change in its own financial situation, it is important to increase contact with the financial institutions with which it transacts business. This is especially true if the congregation has outstanding loans or depends on a line of credit with its bank. It may also be good to discuss whether a committed line of credit is advisable, even at a small cost, in order to address periodic cash flow needs and to ensure that funds are available if and when they are needed.

Concluding considerations:

The creation of a contingency plan should begin with prayer and thanksgiving for the blessings of life already bestowed by God. Discussions of a congregation’s income, cash flow, debt and expense management are vital to a congregation’s ministry. God’s promise of new life through Jesus Christ is the foundation of all congregational deliberations. As a result of this promise we continue to minister faithfully even in times of economic turmoil and uncertainty

Appendix C: Finance and Accounting Procedures

Fiscal year

As mandated by Zion's constitution the fiscal year runs from February 1 through January 31. This captures the receipts for the calendar year from the congregation's members. The monies that are received in December and passed on proportionately in January are booked in the month of January. The fiscal year stays open through January 31 to allow for this lag in recording income for the calendar year.

Accounting Method

Financial transactions should be recorded in such a way that a bookkeeper or successor treasurer will be able to both understand historical data and consistently process new transactions. Additionally, financial statements should be presented in such a way that they are easily understood. Zion's financial condition needs to be clearly understood by lay and rostered leaders, ministry partners and other interested parties. In evaluating the needs of the congregation, it is important for the congregation's leadership to determine its preferred method of accounting. The accrual method is the only method of accounting that conforms to the provisions of Generally Accepted Accounting Principles (GAAP) in the U.S.A. This method provides the most information regarding the financial status of an organization. Zion uses the accrual method of accounting.

Reports

Balance sheet
The balance sheet shows the financial position of an organization at a given point in time. It summarizes the assets, liabilities, and fund balance.

Statement of revenue and expense
The revenue and expense report provides a summary of the operating results for a specific period of time. Revenue and expense reports may be shown in great detail or may be shown in a summarized manner depending on the needs of the user.

Statement of cash flows
The statement of cash flows provides a summary of the sources and uses of funds during a specific period. It is an outline of the cash receipts and cash disbursements.

Management reports
There are additional reports that congregations may find useful. The congregation should assess their needs periodically and determine the extent and scope of their reporting needs. Financial reports that do not communicate and do not get used are not doing the job.

Steps in safeguarding offerings and deposits

These same concepts apply to Zion's auxiliaries and organizations. The congregation council is constitutionally responsible for the financial and property matters of the congregation (C12.05).

Cash transactions must always be handled in dual custody. The following functions will be the responsibility of Financial Secretary:

- Oversee the counting of offerings.
- Oversee depositing of receipts
- Train individuals involved in counting the offerings.
- Report to the treasurer the total offerings each week and any special purpose breakdowns.
- Oversee recording of contributions to the individual contribution records
- Report on levels of giving to the church council and congregation.
- Provide periodic and annual statements to the contributors for tax reporting.

1. Immediately following the service, two people carry the contents of the offering plates to a secure room for counting or placed in an adequate safe for counting the following day. Church funds or offerings will never be taken to a private residence for counting.
2. The envelopes are immediately opened by at least two people. Envelopes are marked as to intent and purpose if for other than undesignated offerings.
3. Balances between envelope totals and cash and check totals are reconciled.
4. A summary report outlining the various accounts income is to be credited to must be prepared and initialed by at least two people.
5. A deposit slip is prepared, and the deposit taken to the bank promptly.
6. Copies of the deposit slip and the summary report are given to the treasurer and to the financial secretary.
7. Individuals responsible for handling offerings and deposits will be rotated periodically. The treasurer and the financial secretary will not be personally involved in the process.
8. There will be clear segregation of duties and the people involved in handling income will not be involved in handling of expenditures.
9. Funds collected from other activities (fundraisers, special events, etc.) will be directed to those responsible for recording and making bank deposits of these funds. Copies of the deposit slip and summary report will be given to the treasurer and financial secretary.
10. Members are encouraged to make their offering by check or electronic payment, not cash. The congregations will send out quarterly ‘giving’ reports.

Steps in handling expenditures

1. Bills and obligations should be approved for payment by an authorized signatory. This approval should be indicated in writing by the person responsible. A purchase or approval form will be used to approve payments and identify the accounts to be charged. Expenditures should be supported by original invoices or receipts, not photocopies, whenever possible. In cases of ACH transfers, all support provided to the Congregation by the bank should be maintained.

2. Check is prepared by someone other than the person approving the expenditure.

3. Check is signed by individuals authorized under the bank account agreement. Dual signatures are required for checks over $7500.00. The pastor will not be an authorized signer.

4. Blank checks will never be signed in advance under any circumstance.

5. Check numbers are written on invoices or support documents to prevent duplicate payment, and checks should be mailed directly to the vendor by the accounts payable staff.

6. At least three individuals will be involved in the above four steps.

7. Savings and investment accounts – if the financial secretary and/or treasurer is authorized to initiate fund transfers to or from these accounts via telephone, it is suggested that a verification notice (written form) be developed indicating that on a specific date such transfer took place (and for what purpose) and signed by the president of the congregation. This form is to be retained in the files of these accounts.

Bank reconciliations

Individuals independent of the process will be responsible for reconciling the savings and investment accounts.

Payroll Tax obligation

In January the Treasurer will: distribute 1099's prepared by the accountant (*Paycheck*) to employees by January 31; distribute W-2's to employees who do not have an online account and will send 1099 information to the accountant (*Paycheck*)

Personal Property Tax

The Treasurer will complete the personal property tax form in March (due April 15). The real estate/property tax payments are due in July.

Insurance coverage

The Finance Committee, subject to approval by the church council, will secure adequate insurance coverage to safeguard the assets of the congregation. In February the Treasurer will pay twice-annual church/worker's compensation insurance. In August the twice-annual Church/Worker's compensation insurance will be paid (due 8/15). The cemetery bill for Insurance will be sent to the cemetery treasurer at this time.

Appendix D:
Accountable Reimbursement Policy

Zion Lutheran Church ("congregation") recognizes that certain expenses of ministry paid by the pastor/staff member are part of the ordinary and necessary costs of ministry in this congregation. Accordingly, we hereby establish an accountable reimbursement policy to defray them directly. The costs for reimbursement of ministry expenses shall be estimated and included in the annual congregation budget. It shall be in addition to the pastor's annual salary and housing.

The following requirements for the policy are binding upon the congregation and upon each pastor and staff person.

Accordingly, the congregation hereby establishes an accountable reimbursement policy, pursuant to IRS regulations and upon the following terms and conditions:

1. The pastor/staff member shall be reimbursed for his/her ordinary, necessary, and reasonable business expenses, documented in accordance with IRS policies, incurred in the conduct of the ministry for, and on behalf of, the congregation.

2. The executive committee or treasurer, (as designated by the congregation) must be given an adequate accounting of each expense, including, but not limited to, a statement of expense showing the amount, date, place, business purpose and business relationship involved. Such documentation shall include receipts for all items of $25 or more. Appropriate documents, cash receipts, canceled checks, credit card sales slips and contemporaneous records for those non-receipt expenses less than $25 must be attached to each expense report. A log of total miles per day and enumeration of their general purpose shall suffice to substantiate automobile mileage, but under no circumstances will commuting mileage between the pastor's home and church office be reimbursed. Copies of the documentary evidence and expense report shall be retained by both the pastor/staff person and the congregation. The president or member of the executive committee (or treasurer) shall be responsible for approving the expense. No person may approve his/her own expenses. The executive committee (or treasurer) shall exercise discretion regarding the adequacy of the substantiation and the appropriateness of any reimbursement.

3. It is the intention of this policy that reimbursements will be paid after the expense has been incurred by the pastor/staff person. Substantiation must be provided within sixty (60) days of incurring the expense. However, should circumstances require payment of an advance for any particular anticipated expense, the pastor/staff member must account for the expense and return any excess reimbursement within 30 days of the issuance of the advance. Any excess advance must be returned to the congregation before any additional advances are provided to the pastor/staff person.

4. Accountable Budgeted amounts not spent must not be paid as a salary bonus or other personal compensation. If such payments are made, the entire amount of the payment for which there is no documented expense will be taxable income to the pastor/staff member. Disposition of any unspent balances remains at the discretion of the congregation in building the budget for the next fiscal year.

5. It is understood by the various parties that all elements of this resolution must be carefully followed to prevent the congregation from being required by regulation to list total payments for business expenses on IRS reports (W-2) as "includable compensation." The primary responsibility for meeting the requirements of expense reporting belongs to the individual incurring the expense,

Adopted on_____, by the Congregation Council of Lutheran Church.

Appendix E: Policy on the use of Credit Cards

Payments made by credit cards are subject to the same best practices, legal and IRS regulations as any other payments and require proper authorization. Approval and recordkeeping are crucial.

It is a good idea to obtain a credit card from Zion's leading bank as the relationship with the bank could help if difficulties or problems occur. Ensure that the terms and conditions of the credit card agreement are fully understood including the APR, payment due dates and pertinent conditions affecting the use of any account checks and their related fees and interest charges. The card limit must be reasonable based on the expected usage and cash advances are not authorized.

While some online and telephone transactions can only be done by credit card, a prompt expense reimbursement system could process reimbursements for expenses charged to personal cards well before a credit card bill arrives. For the sake of convenience, credit cards may be a good option for necessary expenses. However, on credit cards, the payment obligation occurs at the time the card is used. This makes it different from payment by check, in which case the expense is reviewed and approved according to policy before payment is issued.

Card issuers will require the name and personal identification information for the responsible individual, even on a 'company' card. The Zion staff members with custody of the credit card are the Treasurer and Copastors.

Employees and officers of Zion are authorized to make charges using the church credit card. Credit card users are prohibited from using the card for personal (non-business) charges. The congregation is exempt from sales tax charges under state law and arrangements will be made to ensure the individual using the credit card avoids sales tax charges.

The treasurer or authorized person, other than the primary cardholder, will carefully review each month's transactions. All disputes, problems, etc. will be referred to the Treasurer for resolution. The credit card bills will be paid by the treasurer. All charges will be documented, reconciled, and securely filed by the treasurer.

Appendix F: Congregational Audit

What is a congregational audit?

> This is a practical, working definition of an audit for the congregation:
> A congregational audit is an independent evaluation of the financial records and the internal controls of the congregation for the purposes of providing an opinion on the reasonableness of the congregation's financial statements and recommending improvements to its internal controls.

An audit involves completing a set of procedures that in the judgment of the auditor will present the evidence or information needed to provide an opinion on the financial statements of the congregation. These procedures also provide insight as to whether a congregation's internal controls are adequate.

Who should perform the audit?

An internal audit will be conducted yearly. If the congregation determines that it is not economical to have an external audit every year, then it might weigh the cost/benefit of having an external audit performed on a two- or three-year cycle with an internally staffed audit performed in the interim years.

Professional financial auditors (Certified Public Accountants) follow professional standards in conducting their audits. To a professional auditor or accountant, how we have laid out the congregational audit may be closer in professional jargon to a "review." Audit judgment involves determining which and to what extent these procedures should be applied in reviewing each area. The materiality ($ size) of each area is a key consideration in making these judgments.

Who should oversee the audit?

Zion's Constitution states that the Congregation Council shall be responsible for the financial and property matters of this congregation. The Constitution provides for an Audit Committee:

> C13.03. An Audit Committee of three voting members shall be elected by the Congregation Council. Audit Committee members shall not be members of the Congregation Council. The term of office shall be three years, with one member elected each year. Members shall be eligible for reelection.

It does not specify what kind of work an audit committee must do. Nor is there any requirement that the audit be performed by a professional, that it conform to generally accepted auditing standards, or that it be prefaced by the usual representations and caveats that auditing firms incorporate into their audits.

An audit committee is meant to provide the oversight necessary to promote a strong control environment and to afford reasonable assurance that good stewardship is being used in handling and accounting for the funds and other assets of the congregation.

When should a congregation have an outside audit (CPA) firm perform its audit?

Congregations with annual receipts in excess of about $400,000 should seriously consider engaging an outside auditing firm to perform the audit. This is a recommendation and is not binding but is prudent stewardship since more complexity is involved as receipts and expenditures become larger. Even if a congregation feels the audit expense is too great to do every year, they should set an “every other year” or “every third year” pattern, budget for it, and stick to it.

What does an audit do?

An audit should:

- Verify the reliability of the financial statements, including procedures to:
    - Independently verify the integrity of the reports of the treasurer(s);
    - Provide assurance that receipts are properly safeguarded, deposited in a timely manner, and properly classified in the financial statements;
    - Independently verify the existence of cash and accounts receivable and that all bank accounts are reconciled on a monthly basis by someone who is not allowed to write checks; o Independently verify the amount of indebtedness;
    - Ensure that expenses are properly supported and approved;
    - Verify that donated and earned funds of the congregation have been used and recorded as stipulated by the donors.
- Evaluate the effectiveness of key financial controls such as accounting controls (systems that reduce the possibility of loss or errors);
- Evaluate segregation of duties (assurances that more than one person is involved in critical steps in handling money so that there can be checks and balances);
- Evaluate reasonableness of systems and procedures in the light of all factors, including the size of the congregation and its budget;
- Assure adequacy of insurance coverage;

- Establish systems for retaining and accessing meeting minutes that have financial implications (e.g., Finance Committee, Trustees, Congregation Council); and
- Verify records that show donors' stipulations for the use of gifts made to the congregation.

A congregation's unique circumstances may suggest that additional steps should be taken. It is important to document the different financial processes of your particular congregation. Additional steps will be discussed in the next few pages.

What about auditing money held by groups within the congregation?

It is important that all ministries of the congregation be accountable. This means that the treasuries that are to be audited include:

- Financial Secretary or Bookkeeper
- Congregation Treasurer
- Trustees Treasurer
- Memorial Fund Treasurer (if any)
- Congregation Foundation or Mission Endowment funds
- All other separate treasuries or bank accounts maintained by a group using the same tax identification number as the church, including youth group, pastor's discretionary fund, church school, and others.

What about confidential information and retention?

The person(s) conducting the audit may obtain access to confidential information and must treat that information with care. The auditor's work papers may contain confidential information. These work papers as well as all financial records should be retained as per ELCA recommendations in a secure, limited access storage area.

When is a congregational audit best conducted?

An audit is usually best performed after the books are closed for the year and the treasurer and financial staff are available to provide the needed information and answer any questions needed to support the audit process. Waiting too long after the year-end close may make it more difficult to retrieve needed information from the prior year. Before the audit begins, the auditor should prepare confirmation forms for banks, the synod, insurance companies and donors. Those confirmations are essential for providing the auditor with independent verification of bank account balances and authorized signatures, monies sent to the synod for benevolence funds and special gifts, the coverage level(s) and related premiums for all insurance policies and, on a test basis, donor contributions. Confirmations should be sent directly by the auditor to the bank, synod and insurance companies and replies should be returned directly to the auditor.

How does the actual audit process begin?

An audit typically starts formally with an introductory meeting with the treasurer of the congregation. Prior to this meeting the auditor would hopefully have had a chance to review the congregation's financial statements and audit program to identify the scope of the audit and key information needed. The audit program identifies the information typically used to perform each section of the audit. At this meeting the scope would be reviewed and key information (e.g., policies, procedures, information needed to create confirmations for bank and other accounts, other information) obtained. It is important to get the confirmations mailed out early since time must be allowed to obtain responses and any needed follow-up.

What is the auditor's report?

When the audit is complete, the auditor should prepare a written report for presentation to the finance committee and Congregation Council.

The written report should include at a minimum:

1. A scope of the areas reviewed.
2. An overview of the control environment – what was found to be operating as intended and what was not.
3. A listing of comments and recommendations
4. Statement of financial position (balance sheet)
5. Statement of changes in net assets (income statement)
6. Statement of cash flows
7. Comments, if any, on the reliability of the financial reporting, including any correcting entries proposed
8. Comments, if any, on insurance policy coverage
9. Comments, if any, on compliance with donor restrictions on gifts

When all these steps have been completed, the auditor should review the work done with the congregation treasurer and financial secretary, endeavor to answer any lingering questions, then prepare the report.

How and when is the audit report prepared?

The audit report is prepared when the audit is complete, i.e., when the auditor is reasonably assured that the financial records are in order, financial policies have been complied with, any discrepancies have been investigated, and controls have been reviewed. After everyone agrees on the findings, recommendations, and the tone of the report, the auditor is ready to present the Report of the Annual Audit to the Committee on Finance and the Congregation Council. The audit results should be treated confidentially to be shared with the Congregation Council and others only as needed.

Conducting an audit

January

Treasurer will provide the following prior year files to Finance/Audit Committee for year-end audit including:

- **a.** Paid invoices
- **b.** Payroll
- **c.** Bank statements
- **d.** Financial Statements (including full year general ledger)
- **e.** Offering Summary Statements
- **f.** ELCA Audit Report for sign-off by finance/audit chair (mail to Synod treasurer)

August

- Prepare Insurance Audit

September

- Insurance Audit – send necessary reports for annual insurance audit (Worker’s Compensation) to the insurance company.

AUDIT STEPS

The Congregational Audit Guide published by the ELCA (https://www.elca.org/en/Resources/Financial#FinanceC) provides some suggested audit procedures that can be used by the congregation in performing its own audit when retaining the services of a professional audit firm is neither required nor feasible.

Appendix G: Zion's Business Ethics and Conflict-of-Interest Policy

This Operational Ethics Policy addresses conflicts of interest and business ethics but does not include the other ethical values and policies of Zion.

1. Each person who is a director (Zion Council member), officer, committee member or employee (all referred to below as "Congregation Representative") of Zion shall exercise good faith and best efforts in the performance of his or her duties to the Congregation and all entities affiliated with the Congregation. In all dealings with and on behalf of the congregation, or any affiliated entity, these Congregation Representatives shall be held to a standard of loyalty and honest and fair dealing with the Congregation and its affiliated entities.
2. No Congregation Representative shall use his or her position, or knowledge gained therefrom, so as to create a conflict, or the appearance of a conflict, between the interests of the Congregation or any affiliated entity and the other interests of such Congregation Representative. In all matters affecting the Congregation or any affiliated entity, no Congregation Representative shall take any position or engage in any act that could adversely affect the Congregation or any affiliated entity.
3. No Congregation Representative shall accept any material compensation, gift, or other favor that could influence or appear to influence such person's actions affecting the Congregation or any affiliated entity.[1] Each Congregation Representative should promptly disclose to the pastor, an officer of the Congregation, or a committee chair (and as appropriate to the board or committee) any gift, employment, activity, investment, or other interest that might compete or conflict, or appear to compete or conflict, with the interests of the Congregation or any affiliated entity. At the discretion of an officer or committee chair, the matter may be referred to the Congregation Council or Executive Committee.
4. No Congregation Representative should vote or be counted in determining the quorum for any vote, on any transaction between the Congregation and any other corporation, firm, association, or other entity in which such Congregation Representative has a direct or indirect substantial financial interest. Any such duality of interest should be disclosed by the Congregation Representative to the other appropriate Congregation Representatives

[1] Occasional *de minimis* gifts of less than $75.00 value, such as flowers or foodstuffs, are exempt from this rule. Gifts that primarily benefit the Congregation and not an individual, such as gifts of hospitality that may be given to the Congregation by businesses in relation to official Congregation business, are exempt from this rule. Persons also may participate in reasonable, normal relationship-building activities, such as meals or entertainment events.

as applicable and made a matter of record. In addition to refraining from voting, no Congregation Representative should participate in the deliberations or use personal influence in the matter. Any transaction that involves a Congregation Representative should be at least as fair and reasonable to the Congregation as a transaction involving independent parties.

5. For the purposes of Section 4, a Congregation Representative is deemed to have a direct or indirect substantial financial interest in any corporation, firm, association, or other entity in which such person, or such person's parents, spouse, or all descendants of either of such person's parents or such person's spouse have an aggregate, beneficial, equity interest of one percent or more.
6. If a question exists as to the substantiality or significance of a financial interest or conflict and the appropriate action by the Congregation Representative in light of the interest or conflict, the Congregation Representative should seek advice from members of the Congregation Council Executive Committee.
7. After adoption, and then on an annual basis, the secretary, or other person designated by the Congregation Council, shall send a copy of this policy to each director, officer, committee member and employee of the Congregation. All new Congregation Representatives should be given a copy of the policy. Such delivery may be electronic. The Congregation also shall work to make this policy accessible through other methods, such as on the Congregation website.
8. It shall be the duty of each Congregation Representative to inform the Congregation Council or other appropriate person or body of any conflicts of interest in a timely fashion. No Congregation Representative, in his or her capacity as such, shall act as, or represent that he or she is, an agent of the Congregation or any affiliated entity, unless specifically authorized to do so by the Congregation Council.
9. A Congregation Representative has a duty to disclose all breaches of this policy. There will be no retaliation for good faith complaints, reports, or participation in an investigation.
10. Violation of the policy may result in termination from the Congregation position, as appropriate.

Adopted by Congregation Council ___ [DATE]_______

Appendix H: Reserve Policy: Operating Reserve

Purpose

The purpose of the Operating Reserve Policy for Zion Lutheran Church is to ensure the stability of the mission, programs, employment, and ongoing operations of the organization. The Operating Reserve is intended to provide an internal source of funds for situations such as a sudden increase in expenses, one-time unbudgeted expenses, unanticipated loss in funding, or uninsured losses. The Reserve may also be used for one-time, nonrecurring expenses that will build long-term capacity, such as staff development, research and development, or investment in infrastructure. Operating Reserves are not intended to replace a permanent loss of funds or eliminate an ongoing budget gap. It is the intention of the church for Operating Reserves to be used and replenished within a reasonably short period of time. The Operating Reserve Policy will be implemented in concert with the other governance and financial polices of Zion and is intended to support the goals and strategies contained in these related policies and in strategic and operational plans.

Definitions and Goals

The Operating Reserve Fund is defined as a designated fund set aside by action of the Church Council. The minimum amount to be designated as Operating Reserve will be established in an amount sufficient to maintain ongoing operations and programs for a set period of time, measured in months. The Operating Reserve serves a dynamic role and will be reviewed and adjusted in response to internal and external changes.

The target minimum Operating Reserve Fund is equal to six months of average operating costs. The calculation of average monthly operating costs includes all recurring, predictable expenses such as salaries and benefits, occupancy, office, travel, program, and ongoing professional services. Depreciation, in-kind, and other non-cash expenses are not included in the calculation. The calculation of average monthly expenses also excludes some expenses. Examples are pass-through programs, one-time or unusual, capital purchases. The amount of the Operating Reserve Fund target minimum will be calculated by the Treasurer each year after approval of the annual budget, reported to the Finance Committee/Church Council, and included in the regular financial reports.

Accounting for Reserves

The Operating Reserve Fund will be recorded in the financial records as Council-Designated Operating Reserve. The Fund will be funded and available in cash or cash equivalent funds. Operating Reserves will be maintained in a segregated bank account or investment fund, in accordance with investment policies OR will be commingled with the general cash and investment accounts of the organization.

Funding of Reserves

The Operating Reserve Fund will be funded with surplus unrestricted operating funds. The Church Council may from time to time direct that a specific source of revenue be set aside for Operating Reserves. Examples may include one-time gifts or bequests, special grants, or special appeals.

Use of Reserves

Use of the Operating Reserves requires three steps:

1. **Identification of appropriate use of reserve funds.** The Pastor(s) and staff will identify the need for access to reserve funds and confirm that the use is consistent with the purpose of the reserves as described in this Policy. This step requires analysis of the reason for the shortfall, the availability of any other sources of funds before using reserves, and evaluation of the time period that the funds will be required and replenished.

2. **Authority to use operating reserves.** Authority for use of 5% of current budget for items not included in the budget or up to $15,000 of Operating Reserves. is delegated to the Pastor(s) in consultation with the Treasurer and/or Chair of the Finance Committee. The use of Operating Reserves will be reported to the Executive Committee/Board of Directors at their next scheduled meeting, accompanied by a description of the analysis and determination of the use of funds and plans for replenishment to restore the Operating Reserve Fund to the target minimum amount. The Pastor(s) must receive prior approval from the Executive Committee/Church Council for use of Operating Reserves in excess of $15,000.

3. **Reporting and monitoring.** The Pastor(s) are responsible for ensuring that the Operating Reserve Fund is maintained and used only as described in this Policy. Upon approval for the use of Operating Reserve funds, the Pastor(s) will maintain records of the use of funds and plan for replenishment. He/she/they will provide regular reports to the Finance Committee/ Church Council of progress to restore the Fund to the target minimum amount.

Relationship to Other Policies

The Church shall maintain the following Council-approved policies, which may contain provisions that affect the creation, sufficiency, and management of the Operating Reserve Fund.

- Financial Policy
- Budget Policy
- Investment Policy
- Contingency or Disaster Preparedness Plan

Review of Policy

This Policy will be reviewed every other year, at minimum, by the Finance Committee, or sooner if warranted by internal or external events or changes. Changes to the Policy will be recommended by the Finance Committee to the Church Council.

Operating Reserves

The Council-Designated Operating Reserve Fund (Fund 2) is defined as designated funds set aside by action of the Church Council for specific use.

Permanently restricted funds

A permanently restricted fund is typically a gift for which the donor has stipulated that the principal is to be maintained in perpetuity. The donor may also stipulate that the income from the investment activity may be expended for specific purposes such as scholarships. Endowment funds are a notable example of permanently restricted funds.

General Ledger Mission Plus Money Market Accounts 9180014149	**Sub account**	**Specified Use**	**Notes**
021-02-07-	08: Youth Trust	Use and administrative principles should be evaluated each year by the Church Council. The fund shall be accumulated each entire year and settlement made to Youth and Family Ministry (formerly Church and Youth) Program Treasuries (021-02-05-02 at year's end. To be used as a supplement to the Church's budgetary item for Youth Work, and not as a substitute making possible	Zion's Supplemental Youth Activities Trust Fund was established in early 1981. The Church Council shall oversee and supervise the proper use of this fund. The administrators of the Fund shall establish an annual formula for the distribution of income. The Treasurer shall be the responsible church officer to secure the Fund's assets and to make proper distribution of the income from the Fund upon notification from the Church Council, or the Director of Youth and Family Ministry.

		programs and events not possible through the budgetary item in the Congregation's Annual Budget	
Stock Fund Account	**Sub account**	**Specified Use**	**Notes**
Exelon stock		Used as an investment to generate dividends	Dividends sent to 021-02-05-02? (Designated & Youth)
Mutual Fund	Sub account	Specified Use	Notes
Edward Jones Balance Growth & Income Fund (includes AT&T stock)		Used as an investment to generate dividends	Dividends sent to 021-02-05-02 (Designated & Youth)
General Ledger Account Mission Term/Sel CDs	**Sub account**	**Specified Use**	**Notes**
021-02-08- #30000048180	02: Bartgis Sem Schol	Transfer interest to Acct.021-02-07-18	Use Interest Only do not use Principal
#20000003725	03: Bartgis Sem Schol	Transfer interest to Acct.021-02-07-18	Use Interest Only do not use Principal
#20000006085	12: Unrestricted	Transfer interest to undesignated savings #021-02-05-07	Use Interest Only do not use Principal.

Temporarily restricted funds

Temporarily restricted funds are those that come from donors with the specification that the gift be used for a particular purpose or there is a time restriction on them. Restricted funds can range from a Flower Supply Fund to a Dishwasher Fund to a New Carpet Fund. An individual makes a gift expecting it to be used for a specific item or program. These restricted funds are temporarily restricted until the intended purpose, or the time restriction has been met, after which they are released from restriction.

Insurance Policies	Sub account	Specified Use	Notes
#7631976	04: Policy 5880359	To be used for Building only	Life Insurance Policy

Other Designated Funds

Also called quasi-endowments, board-designated funds are those funds which the council or other governing body, rather than the donor, has determined are to be retained and invested. The council has the right to decide at any time to expend the principal of these funds. For financial reporting purposes, these funds are classified as unrestricted net assets.

Quasi-endowments

General Ledger Mission Plus Money Market Accounts 9180014149	**Sub account**	**Specified Use**	**Notes**
021-02-07-	01: Heritage Preservation	Funds to be used for historic preservation of building	Unrestricted ($15,000 to Hist. Pres.)
021-02-07-	05: Building/Cap Expand	For building/capital improvement	Voya Unrestricted ($15,000 to Building)
021-02-07-	19: Future Needs		Insurance-Voya Unrestricted ($75,560.48- Fut Need)
021-02-07-	02: Community Need	Pastor's discretion	
	12: Organ Fund		
	18: Bartgis Seminary Schol		Interest transferred in from 021-02-07-02: Bartgis Sem Schol
General Ledger Mission Plus Money Market Accounts 30000189786	**Sub account**	**Specified Use**	**Notes**
Money Market Acct. #621-02-07-21	Youth Campers	For camp scholarships	
Flexible Payout Deposit Agreements	**Sub account**	**Specified Use**	**Notes**
021-05-01	01: FPDA #9216307	unrestricted	Bequest to Zion Lutheran Church August 2009

			recognized as designated income
	01: FPDA #9251476	unrestricted	Bequest to Zion Lutheran Church Dec 2011. Recognized as current ministry income and transferred to Fund 2 for now
	01: FPDA #5193114	unrestricted	Bequest to Zion Lutheran Church Dec 2017 recognized as designated income
	01: FPDA #5268026	unrestricted	Bequest to Zion Lutheran Church 12/2019 recognized as designated income
General Ledger Savings Account	**Sub account**	**Specified Use**	**Notes**
021-02-05-	02: Designated (& Youth)	This is a savings account that serves as a repository for funds designated for Youth and Family Ministry programs and various misc. funds not identified elsewhere in operating reserves.	Includes AT&T Stock dividend. Interest from 021-02-07-08: Youth Trust shall be transferred into this account at the end of the year. Includes Dividends from Exelon Stock Fund and Edward Jones Mutual Fund.
	07 Undesignated Savings		Undesignated interest from Mission (CD 6085) transferred in from 021-02-08-12: Unrestricted

General Ledger Account Mission Term/Sel CDs	Sub account	Specified Use	Notes
021-02-10- #5474040048836	01		Sale of Valley Register Building – Funds redistributed to CD @ E. Jones for higher rates 9/8/22
021-06-03- Discover Bank E. Jones CD	01		Opened 9/2022
Morgan Stanley E. Jones	02		Opened 9/2022
Morgan Stanley E. Jones	03		Opened 9/2022
021-01-05- E. Jones Savings	08	In Ed. Jones Sav to be used for CD-can only be opened by $1000 – to be added to CDs with interest 9/2022	
Stocks	**Sub account**	**Specified Use**	**Notes**
AT&T Edward Jones 021-07-00-00		Dividends are to be transferred to 021-02-05-02: Designated (& Youth)	
Warner Edward Jones 021-07-00-01		Dividends are to be transferred to 021-02-05-02: Designated (& Youth)	
Exelon Corp 021-08-00-00		Dividends are to be transferred to 021-02-05-02: Designated (& Youth)	
Constellation Corp 021-08-00-02		Dividends are to be transferred to 021-02-05-02: Designated (& Youth)	

Appendix I: Investment Policy:

Purpose

This policy establishes investment objectives, policies, guidelines, and eligible securities related to all assets held by Zion Evangelical Lutheran Church, primarily for investment purposes. In doing so the policy:

- Clarifies the delegation of duties and responsibilities concerning the management of investment funds.
- Identifies the criteria against which the investment performance of the organization's investments will be measured.
- Communicates the objectives to the Finance Committee, staff, investment managers, brokers, donors, and funding sources that may have involvement.
- Confirms policies and procedures relative to the expenditure of investment funds.
- Serves as a review document to guide the ongoing oversight of the management of the organizations' investments.

Delegation of Responsibilities

The Church Council has a direct oversight role regarding all decisions that impact Zion's investment funds. The Council has delegated supervisory responsibility for the management of our investment funds to the Finance Committee. Specific responsibilities of the various bodies and individuals responsible for the management of our investment funds are set forth below:

Responsibilities of the Church Council

The Church Council shall ensure that its fiduciary responsibilities concerning the proper management of Zion's investment funds are fulfilled through appropriate investment structure, internal and external management, and portfolio performance consistent with all policies and procedures. Based on the advice and recommendations of the Finance Committee, the Church Council shall:

- select, appoint, and remove members of the Committee.
- approve investment policies and objectives that reflect the long-term investment-risk orientation of the endowment.

Responsibilities of the Finance Committee

Members of the Finance Committee are not held accountable for less than desirable outcomes, rather for adherence to procedural prudence, or the process by which decisions are made in respect to endowment assets. In consideration of the foregoing, the Committee is responsible for the development, recommendation, implementation, and maintenance of all policies relative to Zion's investment funds and shall:

- develop and/or propose policy recommendations to the Council regarding the management of all investment funds.
- recommend long-term and short-term investment policies and objectives for our investment funds, including the study and selection of asset classes, determining asset allocation ranges, and setting performance objectives.
- determine that investment funds are prudently and effectively managed with the assistance of management (Pastor(s)) and any necessary investment consultants and/or other outside professionals, if any.
- monitor and evaluate the performance of all those responsible for the management of investment funds.
- recommend the retention and/or dismissal of investment consultants and/or other outside professionals.
- receive and review reports from management, investment consultants and/or other outside professionals, if any.
- periodically meet with management (Pastor(s)), investment consultants and/or other outside professionals management, investment consultants and/or other outside professionals.
- convene regularly to evaluate whether this policy, investment activities, risk management controls and processes continue to be consistent with meeting the goals and objectives set for the management of investment funds.

Responsibilities of Management

Management (Pastor(s)) shall be responsible for the day-to-day administration and implementation of policies established by the Church Council concerning the management of investment funds. Management (Pastor(s)) shall also be the primary liaison between any investment consultants and/or other outside professionals that may be retained to assist in the management of such funds. Specifically, management (Pastor(s)) shall:

- oversee the day-to-day operational investment activities of all invested funds subject to policies established by the Council.
- contract with any necessary outside service providers, such as: investment consultants, investment managers, banks, and/or trust companies and/or any other necessary outside professionals.

- ensure that the service providers adhere to the terms and conditions of their contracts; have no material conflicts of interests with the interests of Zion; and performance monitoring systems are sufficient to provide the Finance Committee with timely,
    - accurate and useful information.
    - regularly meet with any outside service providers to evaluate and assess compliance with investment guidelines, performance, outlook, and investment strategies; monitor asset allocation and rebalance assets in accordance with approved asset allocation policies, among asset classes and investment styles; and tend to all other matters deemed to be consistent with due diligence with respect to prudent management of investment funds.
    - comply with official accounting and auditing guidelines regarding due diligence and ongoing monitoring of investments, especially alternative investments. Prepare and issue periodic status reports to the Council and the Finance Committee.

Investment Considerations

The Finance Committee must consider the purposes of both Zion and our assets in managing and investing funds. All individuals responsible for managing and investing Zion's funds must do so in good faith and with the care that an ordinarily prudent person in a like position would exercise under similar circumstances. In making any decision relative to the expenditure of invested funds, each of the following factors must be considered, and properly documented, in the minutes or other records of the applicable decision-making body:

1. general economic conditions;
2. possible effect of inflation or deflation;
3. expected tax consequences, if any, of investment decisions or strategies;
4. the role that each investment or course of action plays within the overall investment portfolio of the fund;
5. expected total return from the income and appreciation of investments;
6. other resources of the organization;
7. the needs of the organization and the fund to make distributions and preserve capital; and,
8. an asset's special relationship or special value, if any, to the organization's purposes.

Guidelines for Investing

The investment goal of the total return fund is to achieve a total return (income and appreciation) of 5% after inflation, over a full market cycle (3-5 years). The following guidelines apply to the three main investment asset classes:

<u>Money Market Funds:</u> Allowable range: Minimum 5%; Maximum 45% of total assets
A quality money market fund will be utilized for the liquidity needs of the portfolio whose objective is to seek as high a current income as is consistent with liquidity and stability of principal. The fund will invest in "money market" instruments with remaining maturates of one year or less, that have been rated by at least one nationally recognized rating agency in the highest category for short-term debt securities. If non-rated, the securities must be of comparable quality.

<u>Equities:</u> Allowable Range- Minimum 20%; Maximum 60% of total assets
The equity component of the portfolio will consist of high-quality equity securities traded on the New York, NASDAQ, or American Stock exchanges. The securities must be screened for above average financial characteristics such as price-to-earnings, return-on-equity, debt-to-capital ratios, etc.

No more than 5% of the equity portion of the account will be invested in any one issuer. Also, not more than 20% of the equity portion of the account will be invested in stocks contained within the same industry.

It is acceptable to invest in an equity mutual fund(s) adhering to the investment characteristics identified above, if it is a no-load fund, without 12(b)(1) charges, which maintains an expense ratio consistent with those other funds of similar investment styles as measured by the Lipper and/or Morningstar rating services.

Prohibited equity investments include initial public offerings, restricted securities, private placements, derivatives, options, futures, and margined transactions.

Exceptions to the prohibited investment policy may be made only when assets are invested in a Mutual Fund(s) that periodically utilizes prohibited strategies to mitigate risk and enhance return.

<u>Fixed Income:</u> Allowable Range- Minimum 35%; Maximum 75% of total assets Bond investments will consist solely of taxable, fixed income securities that have an investment-grade rating (BBB or higher by Standard & Poor's and Baa or higher by Moody's) that possess a liquid secondary market. If the average credit quality rating disagrees between the two rating agencies, then use the lower of the two as a guideline.

No more than 5% of the fixed income portfolio will be invested in corporate bonds of the same issuer. Also, no more than 20% of the fixed income portfolio will be invested in bonds of issuers in the same industry.

The maximum ***average maturity*** of the fixed income portfolio will be 10 years, with no more than 25% of the bond portfolio maturing in more than 10 years.

Prohibited securities include private placements, derivatives (other than floating-rate coupon bonds), margined transactions and foreign denominated bonds.

Exceptions to the prohibited investment policy may be made only when assets are invested in a Mutual Fund(s) that periodically utilizes prohibited strategies to mitigate risk and enhance return.

Performance Measurements Standards

The benchmarks to be used in evaluating the performance of the two main asset classes will be:

- **Equities:** S&P 500 Index- Goal: exceed the average annual return of the index over a full market cycle (3-5 years)
- **Fixed Income:** Lehman Brothers Government/Corporate Index - Goal: exceed the average annual return of the index over a full market cycle (3-5 years).

It will be the responsibility of the Finance Committee to regularly review the performance of the investment account and investment policy guidelines, and report to the Church Council at least quarterly with updates and recommendations as needed.

Expenditure Considerations

The Church Council and the Finance Committee are responsible for the establishment of a balanced reserve fund spending policy to:

a. ensure that over the medium-to-long term, sufficient investment return shall be retained to preserve and grow its economic value as a priority; and,
b. to provide funds for the annual operating budget in an amount which is not subject to large fluctuations from year-to-year to the extent possible.

Expenditure of investment Funds

All decisions relative to the expenditure of investment funds must assess the uses, benefits, purposes, and duration for which the investment fund was established, and, if relevant, consider the factors:

1. the duration and preservation of the investment fund;
2. purposes of Zion and the fund;

3. general economic conditions;
4. possible effect of inflation or deflation;
5. expected total return from income and appreciation of investments;
6. other organizational resources;
7. all applicable investment policies; and
8. where appropriate, alternatives to spending from the investment fund and the possible effects of those alternatives.

For each decision to appropriate investment funds for expenditure, an appropriate contemporaneous record should be kept and maintained describing the nature and extent of the consideration that the appropriate body gave to each of the stipulated factors.

Donor Restrictions

In all instances, donor intent shall be respected when decisions are rendered concerning the investment or expenditure of donor restricted funds. If a donor, in the gift instrument, has directed that appreciation is not spent, Zion shall comply with that directive and consider it when making decisions regarding the management and investment of the fund. Any attempt to lift restrictions on any fund shall be conducted in full compliance with the law.