

The Who, What, When and How of Church Internal Audits

There are several reasons why a church may perform an internal audit. Some churches are required to do so by their constitution or denomination. Others may not need an external audit, or have the resources for one.

Whatever leads to an internal audit at a church, however, it's important to perform it at the right time and through the right process. Below, we explain who and what an internal audit should involve, when to perform one, and how to report the results. These guidelines will help make the process efficient and effective.

Who should perform the audit?

The first task is a very important one: choosing the right person to perform your audit. It may be tempting to go with the first person who volunteers, but that might not be the best choice. Although your denomination may provide checklists and tools to help with internal audits, the person performing the audit must understand the financial data and process well enough to spot any potential issues and ask the right questions.

You should choose an individual who:

- *Is impartial* – The individual selected should not be involved in the church's finances. They also should not be related to anyone on the church's management or accounting team. This will help avoid any perception of bias.
- *Understands accounting* – An understanding of accounting, particularly nonprofit accounting, will help the individual comprehend and perform each step of the audit correctly. They also will be more adept at recognizing and understanding any problems or issues encountered.

- *Has the time* – It's important to choose someone who has the availability to start and finish the audit in a timely manner. Be upfront and make sure the person selected understands that the project requires a significant time commitment.

What should the audit entail?

Although the procedures are too detailed for us to cover adequately here, the following outlines what an internal audit involves:

1. General information acquired by:

- Examining board meeting minutes for financial implications such as purchases of significant fixed assets or loan approvals.
- Reviewing loan documents and other contracts the church has entered into.
- Obtaining a trial balance.

2. Summarized account testing, which should include, but is not limited to, the following areas and steps:

- *Cash* – Review bank statements and reconciliations.
- *Receivables* – Ensure any detailed ledgers are reconciled to the general ledger; ensure any amounts owed to your church are current.
- *Fixed assets* – Verify that all amounts have been recorded correctly and depreciated as necessary.
- *Payables* – Verify that all amounts owed to employees, banks, and vendors are current and recorded in your financial records.
- *Net assets* – Determine whether any donor-restricted amounts have been reported correctly.

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- *Income and expenses* – Compare amounts for the current year with prior-year amounts and review any significant fluctuations. It is often helpful to also compare current-year amounts with budgeted amounts.

When should the audit be performed?

The timing of an internal audit is critical. Although some of the processes can be started before your fiscal year ends, testing of actual account balances needs to be done after the fiscal year is finished and necessary reconciliations are complete. The office, not the internal auditor, needs to be responsible for ensuring that the amounts are correct. Frequency is important as well. Internal audits should be an annual process. If your church completes an internal audit just once every few years, you won't get helpful results or make the best use of your time and effort. It's also helpful to use the same internal auditor each year, if you can, to reduce or eliminate time spent on training.

How should the results be reported?

The key benefit of an internal audit is the information it yields. A report should be prepared at the end of the audit. If you have several different audiences it may be beneficial to prepare multiple reports, each with a level of detail appropriate for the intended audience.

Examples may include:

- A report to the congregation on whether the church's financial information is correct and whether any significant issues or concerns were discovered
- A detailed report to the governing board with specific data, information on any discrepancies, and any suggestions from the auditor
- A report for management that is less formal than the board report, but which provides the specific and detailed information the management team needs to help the board assess and apply any suggestions

Assessing whether you need outside help.

Simple requirements and reports may be sufficient for many churches. If your church is engaged in accounts and activities such as pension liabilities, trusts and annuities, for-profit activities, or other unique activities or investments, however, an internal audit is likely to be too complex for a volunteer and you should consider engaging an accountant.

An internal audit can be the first step toward accountability in a church. The information provided in this article is intended to be used as a starting point for creating an effective and successful internal audit process.

For more information on internal audits, we recommend the *Essential Guide to Church Finance*, written by Richard J. Vargo and Vonna Laue and published by Christianity Today International.

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