



10 ESSENTIALS OF

CHURCH ACCOUNTING AND FINANCIAL REPORTING



Introduction

Introduction

Finances are essential to an organization's ability to operate. That is just as true in churches as it is in other ministries or businesses. Wherever money is involved, there needs to be proper accounting and reporting. The reputation of the congregation and the trust of those who attend the church depend on the proper handling of funds.

The basic concepts of accounting and financial reporting are similar in any entity. For someone who may have financial experience but begins working with church finances for the first time, there are a few unique accounts that you won't see in for-profit financial statements such as:

- **Offerings** – The majority of income for a church comes through voluntary gifts.
- **Pledges** – Givers may make a commitment to give funds over a period of time, still expecting nothing in return but doing so to support the church in general or a particular project.
- **Net assets** – Unlike businesses, people do not own shares or any part of a church. The net assets (equity) of the church are held for the church's use and never distributed for anyone's personal benefit. Net assets are segregated into amounts based on whether the givers contributed funds with or without restrictions.

Money is a tool that allows us to carry out the ministries and programs God has called our church to do. To use that tool in a way that displays excellence and transparency requires skilled people, intentional processes, and appropriate church administration coupled with the oversight of the board. It is a coordinated effort that mirrors the practice of the Apostle

*Now concerning the collection for the saints:
as I directed the churches of Galatia, so you also are to do.
On the first day of every week, each of you is to put
something aside and store it up, as he may prosper,
so that there will be no collecting when I come.
And when I arrive, I will send those whom you accredit
by letter to carry your gift to Jerusalem.
If it seems advisable that I should go also,
they will accompany me.*

1 Corinthians 16:1-4

Paul who stated both clear teaching on giving and explicit instructions regarding the administration of financial collections.

Church accounting and financial reporting calls for engagement by everyone from capable staff to attentive pastors. The call for “approved” people handling money implies a credential that points to proven ability and trustworthiness. The fact that the Apostle Paul himself was willing to assist with the administration should inspire every pastor to get involved as appropriate. These 10 Essentials point the way.

1

Understand the
Impact of the
Numbers

Understand the Impact of the Numbers

Proper accounting and reporting of the financial transactions of the church allows those with decision-making authority to make informed decisions. To do this well, there needs to be good lines of communication within the different ministries and departments of a church.

It can be difficult to get the needed accounting information from pastors or employees if they don't understand why they are being required to do something. For example, the church must have substantiation (receipts) and documentation (explanations) for expenses. This is not just a meaningless exercise. It is to protect the individual from incurring additional taxable income. Explaining that will often yield greater compliance and fewer complaints. Make sure there is clear communication about the requirements and reasons for accounting policies and encourage staff and volunteers to ask questions.

There is sometimes a perception that dollars and time spent on administrative functions such as accounting takes away from resources spent on direct ministry. It is important for the entire staff to understand that just like building a structure on a solid foundation is critical for the long-term sustainability of the building, the infrastructure of administration is vital for the long-term fruitfulness of the church. Stated simply, much less ministry will take place if payroll isn't processed and pastors and staff don't get paid. This foundation consists of time, staffing, and other resources like software and sometimes outside expertise.

Ask a church that has found itself in the position of struggling financially and you will see what a distraction from ministry that can be. Plan well and understand that the reward will be the freedom to focus on the mission and vision of the church.

2

Basis of Accounting

Basis of Accounting

There are three primary methods by which a church can account for its finances:

- 1. Cash.** The cash basis of accounting records income and expenses as the money comes in and goes out. This is the method that most churches use on a day-to-day basis. It makes it easy to understand the daily cash balance and is the simplest approach.
- 2. Accrual.** The accrual basis of accounting records income when it is earned and expenses when they are incurred. For example, an expense would be recorded when the church receives the new Bible study books they ordered rather than when the invoice is paid. This method also recognizes assets and liabilities to reflect a more long-term approach to finances. U.S. generally accepted accounting principles (GAAP) requires the use of accrual-based financial statements. If your church has an audit, the resulting financial statements usually must be presented on an accrual basis. This may be important to outside users of the financial information such as lenders.
- 3. Modified cash.** There is a hybrid of the two previous methods. The modified cash basis of accounting considers many things on a cash basis but may include certain assets and liabilities on the statement of financial position (balance sheet) such as fixed assets or accounts payable. This method may allow the leaders of a church to more clearly understand the value of what the church owns as well as the amounts that are owed for which resources will need to be available.

It is not unusual for a church to operate on a cash basis throughout the year and prepare annual accrual-based financial statements after year-end for reporting purposes. This may help manage cash flow better through the year. It is important to be aware of what expenses have been incurred but not yet paid if a church operates on the cash basis. No one wants to be surprised by an accumulation of unpaid bills!

3

Software

Software

The days of tracking church finances on ledger paper are gone, as are the days of spreadsheets being adequate for most churches. Improvements in technology have made basic accounting packages very affordable. There are four important considerations:

1. The church has reporting needs similar to a business, so your software should provide for “double-entry accounting.” That means when you enter a transaction for money coming in or going out of the bank account it also requires you to record the nature of the related income or expense.
2. Understand that every software package has limitations. Look for one that will meet the most important accounting and reporting needs of the church. Don’t get wooed by features that seem exciting but don’t directly relate to basic functions that are frequently used.
3. It seems obvious, but the accounting system needs to be good at accounting! It is likely the church may want a different system for tracking offerings and attendance. If financial information is kept outside the accounting system (such as a donor management system or a fixed asset tracking system), the systems should be reconciled to each other periodically to make sure all systems are accurate.
4. To fully utilize the software with the least amount of frustration, it is important that users be trained. It can also be helpful to network with staff of other churches that use the same software to learn from one another.

4

Staffing

Staffing

Capable and faithful staff are the most important resource of every church. The leadership of a church should determine if they have adequately provided the following:

- 1. Competence.** It is not helpful to place someone in a position of financial responsibility that does not have the necessary skill set. There is a specific level of knowledge and understanding the individual must have to be able to properly account for the church's financial transactions. This is not a good position to place an unskilled volunteer or an individual the church is hiring as a matter of benevolence.
- 2. Training.** Once the correct person is in place, they should receive ongoing training. Training should be part of the church's budget to keep staff current on new features and also to improve their own knowledge of the software. More options exist today than ever before to take part in educational opportunities while never leaving the office. There are various church network and denominational training opportunities. Many free resources for church finance staff can be found at ChurchEXCEL.org.
- 3. Compensation.** Many churches will not necessarily pay what a comparable position in a for-profit organization would pay, but it is important to be fair in compensation. A church should not resort to a lower skill set than is required because they are unwilling to pay reasonable salaries. There are several national salary surveys available to help determine fair and reasonable compensation.
- 4. Consider the use of volunteers.** It may not be necessary to have paid staff do all the accounting in a church (and many churches don't). The use of volunteers can be beneficial. Be certain to require the same level of expertise that you would for a paid position, however, so the resulting level of work isn't impacted.

5

Chart of Accounts

Chart of Accounts

The basic system of information gathering in accounting is handled through the chart of accounts. Each account is usually assigned a number. A typical structure might look something like this:

1xxx – Assets

2xxx – Liabilities

3xxx – Net Assets (Equity)

4xxx – Revenue

5xxx – Expenses

If you are starting in a new accounting system or would like to make changes to your existing chart of accounts, begin by assessing which accounts are necessary to communicate important financial information. It is always easier to add an account if you find too much information is being handled through one account than it is to take an account away. Consider how “office supplies” is general and yet conveys clearly the purpose of the account whereas “staff meeting coffee” is probably too specific and would have very little activity.

The system should be able to account for gift restrictions, various projects or ministries, and church departments. This can be done by adding additional numbers to the chart of accounts. For example, adding “-10” to any account may signify the expense is related to the children’s ministry. It can also sometimes be done through a different tracking mechanism in the software, such as projects.

Whatever methodology a church uses, it should provide clear and concise financial information and it should be reviewed every few years to make sure it is still adequate to meet the reporting needs of the church. In doing so, it may be helpful to consult with other similar-sized churches and the organization’s CPA.

6

Reconciliations

Reconciliations

Various accounts in the accounting system should be reconciled, or agreed, to other information on a periodic basis. Below is a general overview of the timing and types of reconciliations that may be useful.

Monthly

- **Bank accounts.** All bank accounts should be reconciled monthly with the accounting system. If there are any unusual reconciling items, those should be investigated and resolved. (Investment accounts might be reconciled monthly or quarterly depending on the availability of broker statements.)
- **Petty cash.** Reconciling cash on hand with receipts for purchases made from petty cash ensures amounts are properly recorded, proper documentation has been obtained, and that no cash has been stolen.
- **Donor system.** Amounts in the donor system should be reconciled to the contribution amounts in the accounting system. By doing this monthly, it makes the identification of reconciling items easier. If this is only done annually, it can be difficult to remember why there may have been a difference several months earlier. It also serves as an internal control related to gift processing and can catch potential errors before giving statements are issued.

Quarterly/Annually

- **Payroll.** Form 941 quarterly payroll reporting should be reconciled to the wage and salary accounts at the close of each quarter. This will ensure amounts are properly recognized in the accounting system as well as help verify there have not been incorrect payroll amounts paid.

Annually churches should reconcile the total of the four Form 941s to the Forms W-2 and the Form W-3.

- **Fixed assets.** Recording fixed assets and depreciation can be done annually. Or, it may be easier to do this quarterly if there is significant activity. Making sure supporting schedules agree to the accounting system will be useful to create accurate financial reports.

The church may have other asset or liability accounts that require reconciliations such as inventory or accrued leave liabilities. There are no specific requirements on the frequency of reconciliations. It is usually best to consider the level of complexity and the dollar amount involved and then determine how often the account should be reconciled.

Tip: It may be helpful for the church to prepare a checklist similar to the one on the following pages that shows which accounts are reconciled at what frequency and update it monthly.

ABC Church Reconciliation Checklist

_____, 20____

MONTHLY

Cash:

Bank accounts should be reconciled between the bank statement and the accounting records. Unusual reconciling items should be investigated and resolved as soon as possible. It is also important to follow up on outstanding checks that are significantly outdated (possibly over 6 months). There may be unclaimed property laws in your state that govern how such checks should be resolved. Finally, deposits in transit usually are not more than a couple of days old except possibly at year-end due to timing of contributions received through the mail.

Preparer _____ Date _____ Reviewer _____ Date _____

Petty Cash:

A balance of cash is often kept on hand for smaller purchases. This fund should maintain a consistent balance, such as \$200, and be reconciled to reflect the use of those funds. Receipts need to be obtained for any purchase from petty cash. The check to replenish the balance to its original amount would be expensed to the related accounts (i.e. postage or supplies) rather than to the actual petty cash account.

Preparer _____ Date _____ Reviewer _____ Date _____

Investments:

Broker statements should be reconciled to the accounting records. Each month would reflect the activity such as interest income, fees, unrealized gains and losses, realized gains and losses, purchases, and sales. There are typically not any unusual reconciling items.

Preparer _____ Date _____ Reviewer _____ Date _____

Donor System:

The donor system totals should be agreed to the contribution amounts in the accounting system. There may be reconciling items such as noncash gifts that have a value recorded in the accounting records but are not included in the donor system. However, differences are much easier to determine if they are appropriate when reconciled timely rather than waiting until after year-end.

Preparer _____ Date _____ Reviewer _____ Date _____

Quarterly/Annually

Fixed Assets:

Periodically, a reconciliation should be updated to add newly purchased fixed assets and remove those that were disposed or sold. This would also include information for accumulated depreciation and current year depreciation expense.

Preparer _____ Date _____ Reviewer _____ Date _____

Payroll:

Quarterly payroll reports should be compared to payroll balances in the accounting system. Any differences should be researched.

Preparer _____ Date _____ Reviewer _____ Date _____

Consider additional accounts that may need to be reconciled. They may include:

- Accounts receivable
- Prepaid expenses
- Inventory
- Accounts payable
- Notes payable
- Program revenues such as sales or event income

7

Record Retention

Record Retention

Churches should consider what types of documents (physical and electronic) they have and how long those records should be kept. This includes governance-related materials such as bylaws and church constitution, legal matters like contracts, and financial information including payroll and accounting reports.

A sample records retention policy can be found at [ECFA.org/Content/Records-Retention-for-Churches-Church](https://www.ecfa.org/Content/Records-Retention-for-Churches-Church). Some highlights from that policy include:

- Accounts payable and accounts receivable information – 7 years
- Bank statements – 7 years
- Contribution records – 7 years
- Corporate records – permanent
- Payroll information – termination + 7 years
- Personnel records – vary by type of document
- Property records – permanent
- Tax-exemption information – permanent

Churches should have a process for reviewing compliance with the records retention policy.

8

Internal Controls

Internal Controls

Every church should have a basic understanding of the risks that exist in carrying out its mission. These may include legal risks, physical risks such as icy parking lots or trip and fall hazards, reputational risks, and certainly financial risks among others. Once the risks are identified, a plan can be put in place to mitigate those risks. The mitigation for financial risks often includes a good internal control structure.

The most important internal control in a church is probably the segregation of duties. No single individual should have access to the entire cash receipts or cash disbursements process.

There are usually multiple ways that adequate segregation of duties can be implemented. A church can look for the solution that is the most cost-effective and efficient as possible. The following examples (A, B, and C) are all illustrations of poor segregation of duties that should be improved.

Example A: Offerings are collected on Sunday morning and placed in a safe. The bookkeeper gathers the offerings from the safe, counts the funds, prepares the deposit, updates the giving records, takes the deposit to the bank, and enters the deposit information into the accounting system.

Example B: The treasurer receives invoices for the church, writes checks, signs checks, enters information into the accounting system and reconciles the bank account.

Example C: The treasurer sets up online giving. He/She is the only one who has access to change the account where funds are deposited. The treasurer also enters information in the accounting system.

In Example A, it may be helpful to have two people access the safe and count the funds together. The second person can then verify monthly that the amounts entered into the accounting system agreed with the count sheets that were prepared.

In Example B, it would be helpful to not allow the treasurer to sign checks. The individual that signs checks can review the bank statement monthly looking for any unusual activity or checks that he/she had not signed. This takes limited amount of time and yet provides much better protection for both the church and the treasurer.

Example C could result in funds being deposited to the treasurer's personal account at some point because the treasurer has total control. A separate individual should be

involved in reconciling the online system to the accounting records or be given control over the account access.

Internal controls provide the framework for protecting the financial assets of the church as well as the reputation of the individuals that work with those finances. It is important to understand that when fraud occurs in a church it is often by a trusted individual and was a matter of opportunity. Internal controls are wise protections to keep honest people honest.

Also see ECFA's eBook [**9 Essentials of Church Internal Controls**](#).

9

Financial Reporting

Financial Reporting

The end product of accounting for the church's finances is the financial report that is generated. This may take different forms depending on the audience.

For example, where church boards and banks require full financial reports and are numbers-driven, reports to the leadership teams may be better communicated with charts and graphs because leaders are generally not as financially-minded in the details. Some of this reporting may be dictated by your church bylaws or other guidelines.

- **Ministry leaders.** Individuals that are responsible for a particular portion of the budget such as children's ministry or music should receive information to help them manage those funds. Monthly they should receive a report detailing what their budgeted expenses were in comparison to what was actually spent.
- **Leadership team.** The senior pastor and any other staff members that are part of the church leadership should receive monthly reports including a balance sheet, an income statement comparing budget vs. actual amounts (probably with departmental detail), and a cash availability report showing the cash balance excluding amounts that are currently owed or restricted by donor designations.
- **Finance committee.** The finance committee would receive information similar to the leadership team though they may request more detailed information such as specific account detail, a cash projection, or list of amounts owed to vendors.
- **Governing board.** The board would typically see a balance sheet, an income statement with budget information, and a cash availability report. More detailed questions would often be handled by the finance committee or treasurer.
- **Congregation.** This will depend on the organizational structure of the church. Some churches make an annual financial statement package available upon request. Others have quarterly business meetings where specific financial information is discussed.

It is helpful to provide succinct information and to seek to understand the needs of the users. The keys to any financial reporting are accuracy and timeliness. Inaccurate or late information can result in poor decision making within a church.

10

Involve a
Third Party

Involve a Third Party

After financial information has been recorded and reported, it is always best to allow an independent party to verify the accuracy of the information and to review the accounting processes that are in place. There are many ways this can be accomplished.






- 1. Internal audit.** If a church chooses to use the internal audit function, or is required denominationally to do so, it is important to make sure the procedures are performed by someone who clearly understands church accounting. The Who, What, When and How of Church Internal Audits may be a useful document and is available at [ECFA.org/Content/The-Who-What-When-and-How-of-Church-Internal-Audits](https://www.ecfa.org/Content/The-Who-What-When-and-How-of-Church-Internal-Audits).
- 2. Independent audit.** A certified public accounting (CPA) firm can perform a financial audit to give a formal opinion on whether the financial information is correct within certain parameters. The result of an audit is be a set of financial statements with the CPA's opinion and a letter addressing any concerns about the internal controls or other financial concerns of the church. This is the highest level of CPA engagement.
- 3. Financial review.** A CPA may perform a financial review which is less in scope than an audit and is the result of asking more questions related to the financial information rather than verifying the information against documentation. The result is a similar set of financial statements as an audit, but the level of the CPA's assurance is lower, and no letter need be provided related to internal controls or other findings.
- 4. Compilation.** A CPA may also be hired to compile the financial information. In this type of engagement, there is no assurance as to the correctness of the financial information and they will not review matters related to internal controls.
- 5. Consulting.** For many churches, especially smaller churches, the most beneficial use of time and money may be to hire the services of someone who clearly understands church accounting to review the processes and procedures the church has in place to perform the accounting functions. The consultant (CPA or not) may identify areas of weakness in the internal control structure or be able to provide best practices related to actual accounting functions or financial reporting.

The level of service required may depend on outside factors such as denominational requirements, debt covenants by a lender, or membership or certification requirements

of an organization such as ECFA. Whatever the driving factor for outside involvement in a church's finances, the type of service should be carefully considered to make sure it will deliver the most effective results possible.

In addition to these CPA-related services, your church may also want to work with a screening company to handle background and credit checks for those involved with finances (staff, users, count-team that handles money) and also consider bonding employees who handle cash.

RECOMMENDATIONS FOR INTERNAL/EXTERNAL AUDITS AND CPA ENGAGEMENT

TOTAL ANNUAL REVENUE	RECOMMENDATIONS	
 3M	Internal Audit	 External audit of financial statements (GAAP/GAAS)
2M to 3M	Internal Audit	 External review of financial statements prepared on either the accrual or modified-cash basis of accounting
250K to 2M	Internal Audit	 Compiled financial statements prepared on either the accrual or modified-cash basis of accounting
At least 250K	Internal Audit	 When possible, compiled financial statements prepared on either the accrual or modified-cash basis

Now What?

Action Steps
to Excellence

Now what? Action Steps to Excellence

- Consider if leadership understands the importance of accounting in the church and the part they play in providing accurate financial information.
- Determine if the church has an accounting system that is adequate to meet its accounting and reporting needs.
- Assess if there is adequate competence on staff, or through volunteers, to meet the accounting needs of the church and determine if reasonable compensation is being provided for the paid positions.
- Consider if the current chart of accounts meets the reporting needs of the church.
- Review the church's chart of accounts and determine if any accounts are unused or so small they should be eliminated.
- Create a checklist of required reconciliations indicating how frequently they should be prepared.
- Make sure the church has a current record retention policy and that it is being followed.
- Assess and document risks the church has and determine how to mitigate the most significant of those risks.
- Review internal controls for the church and verify there is adequate segregation of duties specifically over areas such as cash receipts (offerings) and cash disbursements (checks and payroll).
- Review existing financial reports and determine how they meet the needs of various audiences.
- Consider what level of involvement an independent third party should have in the financial information of the church and plan how to begin that process if it is not currently happening.

Resources

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Governance



Financial
Management



Legal
Compliance



Gift
Administration



Leadership

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