

Wednesday, September 09, 2009

The Wardens and Vestry
St. Aidan's Episcopal Church
2425 Colorado Avenue
Boulder, CO 80302-6806

Ladies and Gentlemen:

The primary purpose of the audit is to provide assurance that the financial statements fairly represent the financial position and result of operations of the entity being audited. An audit certificate is required to be provided to the Diocese to evidence compliance with the canonical audit requirement. An additional benefit of the audit, however, is found in the Management Letter in which the auditor has the opportunity to share with management his observations and recommendations pertaining to accounting, internal control and other operating matters which attracted attention during the course of the audit. That is the purpose of this letter.

Status of Prior Year Recommendations:

No audit was done for 2007 and the two previous year audits did not include a management letter.

First, I will discuss the Endowment Fund Accounting, an area I was specifically asked to address during the pre-audit meeting.

1. The Chart of Accounts, as applicable to the Fund

Findings: There is a single line item in the asset section for the Endowment Fund. I understand the Endowment Fund is made up of several items: Cash or cash equivalents; a Vanguard Account; a Colorado Episcopal Foundation (CEF) account; a parish loan account; and an insurance cash value account. Each of these should be identified in the Chart of Accounts as a subsidiary of the Endowment Fund Account. Additionally, I note that the Equity Accounts do not specifically identify the Endowment Fund or any of its components. I understand the components of the Endowment Fund include: The Yearns Bequest (a permanently restricted donor fund); the Founder's Fund (an amount determined as of 12/31/03 upon which distributions are to be made in accordance with the historical practice; and the Vestry Use Fund. Each of these three funds have different distribution policies but the total of these three funds should agree to the total of the invested funds showing as assets.

Recommendations: The Endowment Fund should be reclassified from the Current Asset section of the Balance Sheet to the Other Asset Section of the Balance Sheet. Additionally, establish additional asset and equity accounts to properly account for the location of the fund assets and the equity breakdown of the funds as follows:

Other Assets

Endowment Fund
Cash (Name of Institution)
Vanguard
Colorado Episcopal Foundation
Loan Receivable
Life Insurance Cash Value
Total Endowment Fund

Equity

Endowment Fund
Yeans Bequest
Founder's Fund
Vestry Use Fund
Total Endowment Fund

Note that the two totals above should always be in agreement except for current year income which has not yet been closed to the equity accounts. I recommend the expansion of the Chart of Accounts in order to provide the maximum transparency for the readers of the financial statements, without the need to refer to subsidiary schedules or reports. Finally, Chart of Accounts applicable to Income and Expenses would also need to be expanded. Perhaps a section for the Endowment Account could be provided following the Designated Gift section as follows:

Endowment Fund
Gifts received
Interest Income
Change in value of Investments
Change in value of Life insurance
Less Distributions
Net Change in Endowment Fund

One last recommendation, consider taking all of what was outlined above and moving it into a new Fund Account – 004-Endowment. This fund is significant enough to warrant segregation and you have the accounting system to accomplish it. Bill has advised me of an alternative accounting treatment which should accomplish much the same thing as a separate Fund Account. That is distributing the assets and equity of the Endowment Fund to the 02 and 03 funds for which they are used. I like this idea equally as well as establishing a new fund. This accomplishes the primary goal of segregating the assets, fund equity and income and expense/distributions of the Endowment Fund from that of the Operating Fund.

2. Endowment Fund Financial Records

Findings: There are virtually no financial records of the Fund at the Church. Original statements and reconciliations from financial institutions, worksheets showing the allocation of income and expense/distributions between the three funds and periodic reports to the Vestry were all in the hands of the Fund's custodians and could not be produced timely when requested. There is no indication in the minutes of the Vestry that a financial report of the Endowment Fund was received. The Charter requires that a CPA audit the Fund or that the Foundation's CPA oversee the Fund. This has not been done.

Recommendations: The financial records of the Fund belong to the Church and should always be maintained at the Church. If the Fund Treasurer is doing work outside the church, copies, not original documents, should be taken. The Vestry should request the Fund Treasurer provide a written financial report at least quarterly, in addition to that which is provided in the Annual Report. The report should detail the changes in fund assets as well as the allocation of income and expenses among the components of the fund and the calculation of all distributions from the Fund. If the intention of the Vestry is to accept the report of the Church's auditor, which may not be a CPA, rather than engage a CPA to separately audit the Fund, then it should so indicate the waiver in a formal Vestry resolution so that it is clear the Vestry is not ignoring the requirements of the Charter.

3. Endowment transactions are not being posted to the General Ledger.

Findings: No transactions in the Endowment Fund were posted in all of 2008 and the opening balances were not in agreement with the report of the Endowment Committee.

Recommendations: When the treasurer of the Endowment Committee completes the Quarterly report to the Vestry, appropriate journal entries to reflect the transactions and value adjustments for the quarter should be provided to the Church Treasurer for posting to the General Ledger.

General Comments regarding the Endowment Fund: The lack of records at the Church and the lack of any financial updating of the Fund in the General Ledger resulted in a delay in completing the audit, during which time I asked for a complete reconciliation of the fund over the last two years. This reconciliation was completed. I had originally anticipated that adjusting journal entries would be required to be posted and new financial statements for 2008 prepared. However, after reviewing the reconciliations, the revised/reconciled value of the fund was \$429,973.79. The value showing on the balance sheet is \$432,244.00. This is less than a 1% variance. This is not a material amount. Therefore, I am waiving adjustment for 2008. I do recommend, however, that the recommendations above, regarding the classification of assets, the breakdown into sub accounts to detail the assets, the breakdown into sub accounts of the fund equity, and additional accounts in the Income and Expense area to identify the different types of transaction in the Fund, and the adjustments to bring the books into agreement with the supporting documentation all be made as soon as possible. If this work could be completed within the quarter so that you go into the fourth quarter with an accurate set of books, that would be ideal.

Following are other items that came to my attention during the current audit:

1. Personnel Files

Findings: The personnel files are generally very complete for I-9's, W-4's, Background Checks, etc. I did note a couple of missing documents for Safeguarding God's Children and one SGC certificate that had expired. I also noted an excellent checklist for items that should be included in the personnel file, but it did not appear to be consistently used.

Recommendations: Using the personnel file checklist, review each file for completeness and obtain missing documents where necessary. Develop a schedule of all personnel and volunteers who are required to comply with the Safeguarding God's Children workshop requirements (and others) and note dates taken and dates renewals are due for appropriate follow up. I also recommend adding to the checklist a signed authorization for any employee deductions from the paycheck other than the statutory deductions for taxes. This would cover any deductions for health insurance, 403(b) contributions and the like.

2. Safeguarding God's Children Policies and Procedures:

Findings: Not all required church personnel had workshop certificates, background checks or other required documentation in their personnel file. There did not appear to be any personnel files for volunteers as required by policy. There does not appear to be a formal method of review to insure that all required documentation for workers, salaried and volunteer, is obtained and updated when required.

Recommendations: Add to the Personnel File Checklist all items required per the Safeguarding God's Children policies and double check to be sure they are in the files. Create Personnel Files for all volunteers who are subject to the Safeguarding God's Children Policies and insure that all documentation on volunteers is complete. Develop a schedule of all personnel and volunteers who are required to comply with the Safeguarding God's Children workshop requirements and note dates taken and dates renewals are due for appropriate follow up. Assign a staff person to review this schedule periodically to insure compliance.

3. Discretionary Funds

Findings: I did not attempt to audit either the Rector's or the Chaplain's Discretionary Funds since there were memo's in the file that both had already been audited by others. I commend this practice so long as the person(s) doing this audit are thoroughly familiar with the requirements for discretionary funds as outlined in the *Manual of Business Methods for Church Affairs*. The files for both accounts also appeared to be complete and I noted that summary transactions are entered into the General Ledger asset accounts for each. This is also commendable. I did not find in the files, however, any bank reconciliations, although the bank statements themselves were there and were marked as having been reconciled.

Recommendations: Complete the discretionary files by attaching a copy of the bank reconciliation each month to the bank statements.

4. Bank Reconciliations

Findings: The 12/31/08 Bank Statement Reconciliation for the Designated Funds Account did not agree with that recorded on the books. Adjustment was waived due to materiality.

Recommendations: The Treasurer should scan the bank reconciliation prepared each month by the accountant for any irregularities and should then agree the reconciled amount to that which is actually shown on the Balance Sheet. Any irregularities should be investigated immediately.

5. Health and Life Insurance

Findings: There is a group policy with Humana which appears to cover term life, accidental death, dental and health benefits. It appears that the Rector has elected out of the health benefits and instead is receiving a direct cash benefit. Cash paid directly to the employee is taxable and should be included on the employee's form W-2. This is true even if the intent is for the employee to use it to purchase health insurance elsewhere. Health insurance is a non-taxable benefit only when it is provided through a group policy with the employer. Tax law allows the employee to deduct health insurance costs as an itemized medical deduction, subject, however, to the 7% threshold. As a self employed person with a schedule C, the clergy may also be able to directly deduct health insurance costs. A tax professional should be consulted on this. Additionally, the value of life insurance in excess of \$50,000 is taxable in accordance with IRS tables. The IRS views the Church Pension Fund and the church as a single employer for this purpose and, since the Church Pension Fund provides \$50,000 of life insurance, any additional provided by the church is taxable.

Recommendations: Take steps in the future to be sure that medical benefits paid directly to the employee are properly included in taxable income. Also, the value of the life insurance paid for by the church should also be included in box 1 of the W-2 and in box 12, using the values provided by the IRS.

6. Vestry Minutes

Findings: In reviewing the minute book, financial statements were not regularly attached to the minutes and when they were they were not comparative to budget.

Recommendations: The Treasurer's monthly report to the Vestry should be accompanied by complete financial statements, balance sheet and Income. The income statement is of most value when presented in comparative form to budget and, if possible, also to prior year results for the same period. I believe Shelby has the capability to present both these comparisons. The Treasurer's reports (and any other handouts at the Vestry meeting) should always be filed with the minutes in the Minute Book.

7. Sunday Collections

Findings: The Internal Control Questionnaire indicates that the Sunday Collection is not counted by two independent parties and that the counters do not rotate.

Recommendations: Schedule the Sunday Counters so that there are always two unrelated counters and the counters are rotated each week. If there is difficulty in getting enough counters to volunteer, then perhaps a vestry member or a finance committee member could be scheduled alongside another volunteer.

8. Parochial Report

Findings: I was unable to tie the Income and Expenses showing on the Financial Statements to that which was reported on the Parochial Report. I did not find a worksheet or reconciliation in the Church files to support the numbers shown on the Parochial Report.

Recommendation: The preparer of the financial section of the report should prepare a worksheet showing how the numbers in the financial statements are combined to form the numbers reported on the Parochial Report. This worksheet should be maintained with the file copy of the Report.

9. Form 1099's

Findings: The Internal Control Questionnaire indicates that you do not file 1099's for amounts paid to individuals who are not employees, nor for unincorporated entities.

Recommendations: IRS Regulations require 1099's to be filed for all individuals and non-corporate entities that are paid over \$600 in one year. Fines can be substantial for not doing so.

This concludes my observations and recommendations. I hope you find them of value. My objective is to always add value to the audit report through the use of the Management Letter and I hope I have succeeded in this case.

If there are questions or if you need further information on anything addressed in this report, please do not hesitate to ask. E-mail is always the best way to communicate.

Thank you again for the opportunity to be of service and I hope you will invite me back again.

Faithfully

Robert S. Leaman, President
Leaman and Associates, Inc.