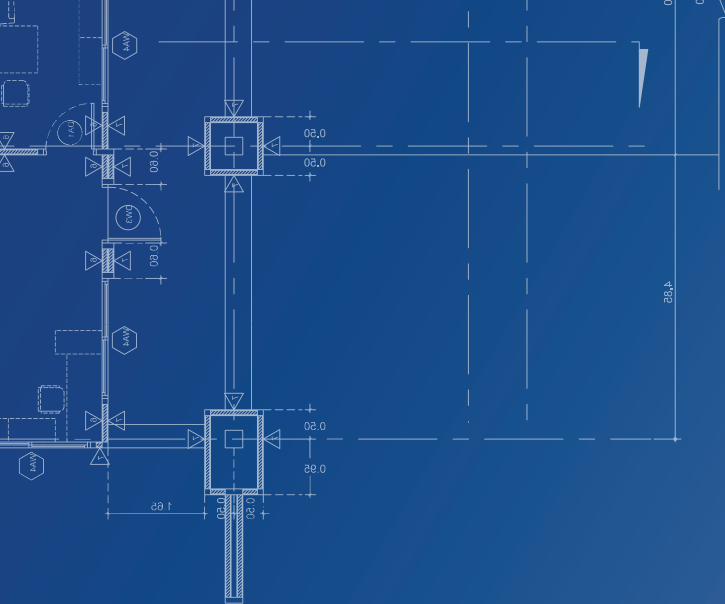
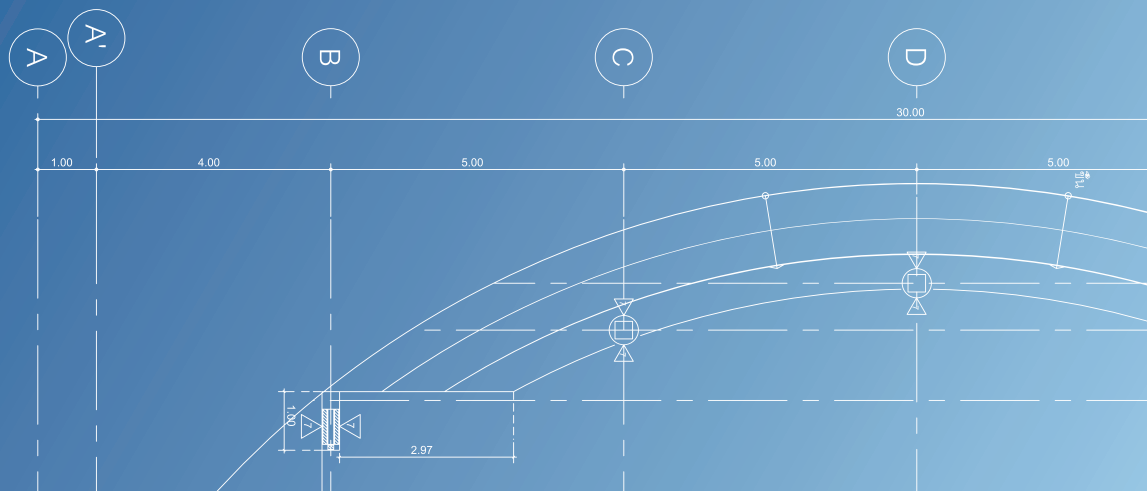




Ministry Brands

Your Blueprint for Church Accounting

The information you need to understand church finance



Content

INTRODUCTION

CHAPTER 1:

What is church accounting?

- Definition of standard terms
- Fun with the fundamentals
- How church accounting differs
- Compliance matters
- Key takeaways

CHAPTER 2:

Best practices

- Your general ledger check-up
- Streamline payables and receivables
- Bank reconciliation: Checks for balances
- Getting rolling with payroll
- Financial reports

CHAPTER 3:

Choosing accounting software

- Plan before you invest
- Refine your search criteria
- Additional features that matter

INTRODUCTION

If I asked you what supporting qualifications that officially classify clergy for payroll purposes, what would your answer be?

Depending on your experience with church accounting, you might quickly blurt out the answer. Some may not have known a clergy tax classification was a thing. One church's accountant may come from a for-profit background. Another could be a minister's sister who was decent with numbers in high school. With such a wide range of personal backgrounds at play, the need for a definitive resource about church accounting—one that's accessible to everyone—is clear.

THIS MATTERS...A LOT

We're taught that numbers are almost always certain, which makes ambiguities in accounting all the more confusing for some. It's why organizations (both for- and non-profit) hire or outsource accounting professionals. Regardless of your association with the church's financial processes, there are four truths about its accounting to keep in mind:

- **Church accounting is different than for-profit accounting**

While most of the accounting basics are very similar between for and non-profit companies, how each employs fund accounting is a key differentiator. A typical for-profit business has a single set of assets, liabilities, and equity accounts, whereas many churches, like yours, may have more than one.

- **Church accounting challenges, regulations, and practices require industry-specific knowledge**

As a tax-exempt entity, your church must adhere to a unique set of regulations and processes to avoid fiscal backlash. There are guidelines governing your federal tax-exempt status and state and local requirements to navigate.

- **Track accountability and stewardship, not profitability**

Businesses focus squarely on the bottom line. They're accountable to shareholders, who potentially have a financial stake in the company's performance. The books are designed to report everything contributing toward profitability. Your service to the community requires bookkeeping that prioritizes accountability for every dollar received.

- **Solid church accounting increases confidence, provides transparency, and contributes to growth**

Prioritizing accountability clears the way for instilling congregants' trust that their donations, gifts, and tithes are used appropriately. In theory, you could show any congregation member where their money goes at any time. Your growth depends on their trust. Trust is earned by doing things the right way, not hiding details.

WHO IS THIS E-BOOK FOR?

The primary readers will likely be office/finance administrators, finance/executive committees, treasurers, or CPAs looking to improve their church's accounting practices. That shouldn't dissuade other finance contributors from reading. Anyone on staff involved in the church's finances could (and should) be familiar with this content.

HOW WILL IT HELP?

Whether new or experienced, there's always something to learn as regulations shift, technology advances, and the church's needs change. Our goals for assembling this content include the following:

- **Fill in the blanks**

Accounting basics for any organization are similar, but churches and non-profits apply them differently. Use this resource to highlight the differences for your team.

- **Increase stewardship**

Good accounting helps the church steward resources well and maximize them for the ministry.

- **Take things seriously**

Though the potential for an IRS audit may be less, that doesn't negate the importance of accurate accounting of every dollar donated/raised.

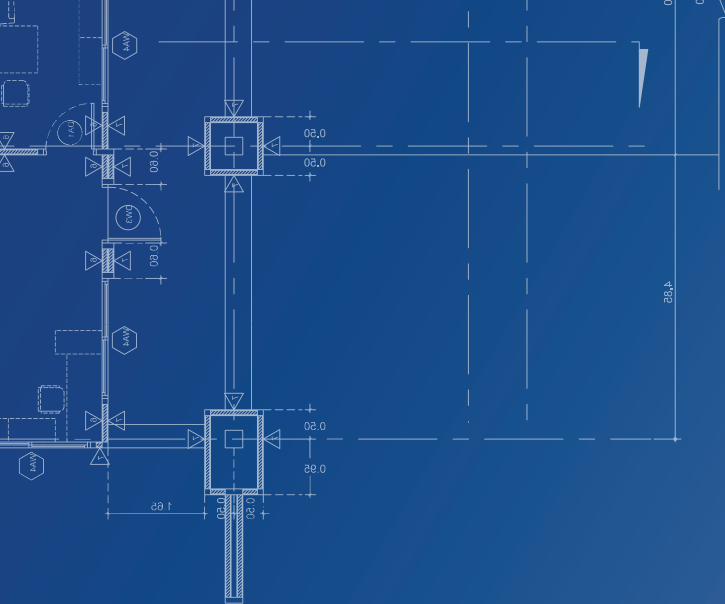
- **Improve compliance**

Expand your knowledge of regulations and the best practices to implement for compliance.

- **Clarify and simplify**

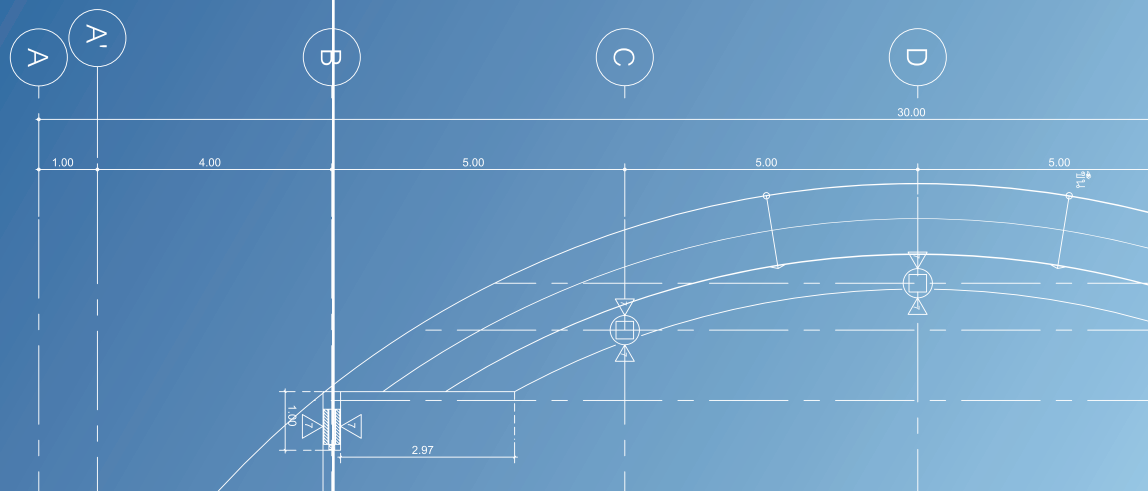
Enjoy the peace of mind that comes with gracefully navigating your general ledger, payables, receivables, bank reconciliations, payroll, and core financial reporting.

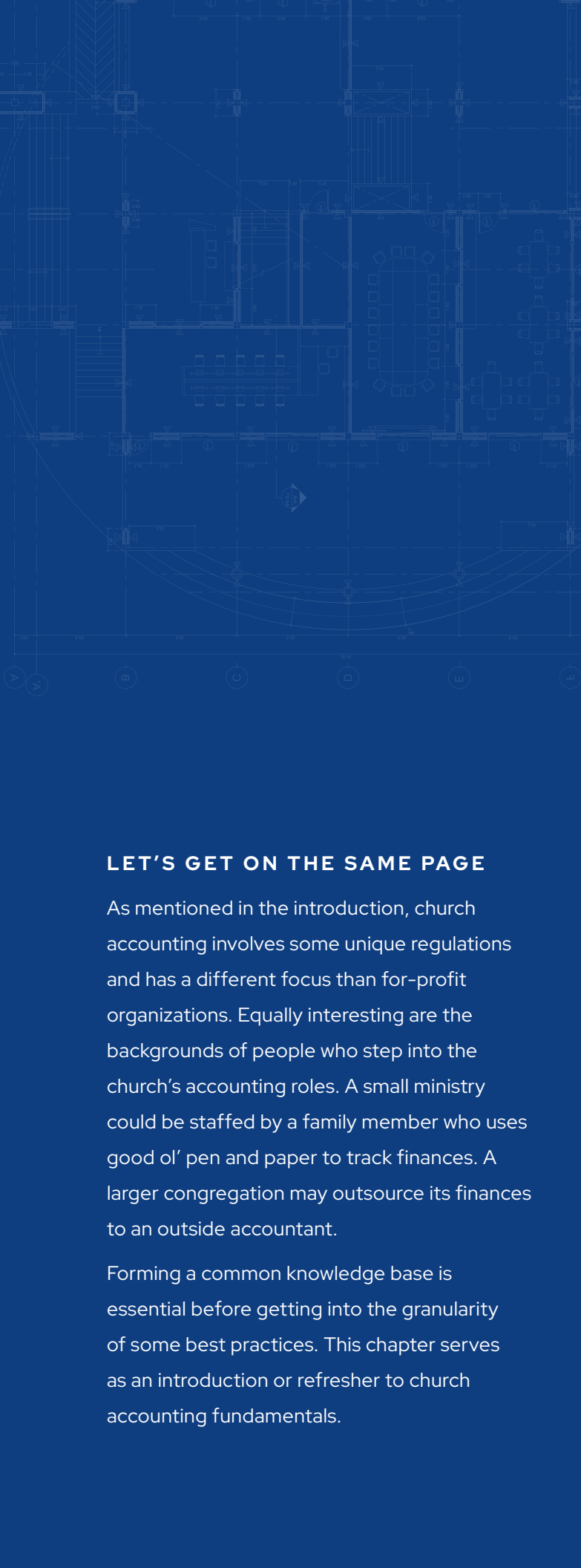
The intent of this eBook isn't to explain every regulatory nuance related to church accounting. That would take hundreds of pages. Instead, it focuses on the essentials anyone in charge of a church's finances should know. Your awareness in these areas contributes to compliance, improves communication between organization members, and increases understanding of the church's overall financial health.



CHAPTER 1

What is church accounting?





LET'S GET ON THE SAME PAGE

As mentioned in the introduction, church accounting involves some unique regulations and has a different focus than for-profit organizations. Equally interesting are the backgrounds of people who step into the church's accounting roles. A small ministry could be staffed by a family member who uses good ol' pen and paper to track finances. A larger congregation may outsource its finances to an outside accountant.

Forming a common knowledge base is essential before getting into the granularity of some best practices. This chapter serves as an introduction or refresher to church accounting fundamentals.

STANDARD ACCOUNTING TERMS

This short vocabulary lesson will align you with some usage of common, modern terminology pertinent to church accounting. You may interpret these foundational elements with different definitions. Some might have learned another word for the same concept. Regardless, orient yourself with our terminology to understand how to apply these concepts to your church accounting processes.

Board designated

Unrestricted, available capital/net asset balances the operating board designates to be spent on their specified purposes. This designation is revocable at any time by the board.

Company

The operating entity of the organization should be the highest level of accounting. All periods and account groupings are subject to the company and, at no time, are entries shared between companies. Occasionally, multiple companies can be shown in consolidated reports, like those that share AP vendors. A company has a few unique properties, such as independence in payroll processing from the settings of other companies.

Donor restricted

There are two types of donor restrictions on donations—temporary or permanent. Contributions can be given by a donor for a specific purpose. This restriction can be temporary or permanent. The donated money must be used by the organization for the donor-specified purpose for the timeframe specified unless the donor permits it to be used differently.

Contributions without donor restriction specifications permit the organization to use the donation as they see fit.

Fiscal Year

The unique time division of accountability, typically 12 months (or periods) in length. Fiscal years can mirror a calendar year (January - December), or can follow another period of time, like an academic calendar year that runs from July - June.

Fund

A fund describes the category or purpose of contributions donors give (e.g., Building Fund, General Fund, Missions Fund, etc.). It can also denote a subsection of a company that maintains its separate assets, liabilities, and net assets/capital accounts, as well as separate income and expenses. Some use "fund" as an alternative name for net asset account balance or a company's bank accounts.

Fund accounting

The GAAP-required form of accounting for all non-profit entities in the United States. It designates that money raised by a non-profit organization must be used for one of three purposes: operations, fundraising, or programming.

Generally Accepted Accounting Principles (GAAP)

Short for Generally Accepted Accounting Principles, GAAP refers to the rules and best practices for proper accounting procedures in the U.S. set by the Financial Accounting Standards Board (FASB).

Net asset account

The non-profit accounting equivalent of a Capital or Retained Earnings accounts in for-profit accounting.

Period

The segment of a fiscal year into which a company's budget and activities are divided. Fiscal years typically contain 12 periods but may have fewer or more depending on rarely occurring specific circumstances.

Were any of the terms in this list new or differently defined to you? If you answered yes, you're not alone. Accounting has a way of being diligently rigid in what it asks of its practitioners, yet remarkably interpretive in its naming conventions.

SELF-CHECK

What are some other church accounting terms you've encountered that are unclear? Write them below so you can research them later.

I want to know more about...

[illegible]

Fun with the fundamentals

Before exploring how church accounting differs, let's explore the fundamentals that apply to for- and non-profit organizations alike.

Accounting is the tracking of debits and credits in monies entrusted to an organization. It's commonly performed utilizing a double-entry system, which is a fancy way of saying that for each debit entry, there is a matching credit entry in the books. Doing so lets you track what was spent or received against your assets' total.

LIABILITY, INCOME, AND EXPENSE ACCOUNTS

Income and expense accounts represent the activity—not actual dollars in the bank. They do not carry over value from fiscal year to fiscal year.

Another account type is the liability account. These usually reflect funds owed to an entity outside of your accounting system. They show funds collected to pay taxes, the amount owed on a mortgage, and also utilized as “pass-through” accounts when a company tracks their books on an accrual basis.

Accrual accounts show activity immediately in an income or expense account when the activity is incurred (before the funds are spent or received). In these cases, the liability account serves as a temporary substitute for the asset account until it is time for the funds to be received or spent. At that point, the second double entry uses the liability and the asset account to complete the transaction.

BALANCE IS EVERYTHING

It's easiest to think of accounting as a scale, one that wants to (and must) remain balanced. For every entry against an asset balance, there must be an equal and opposite effect on another account. When performed correctly, the result is an accurate record of all activity against your funds and matching activity about how they were received or spent.

Each account is tracked to show increases and decreases in value to perpetuate balance. Some get confused by this because they view it backward from how we typically think of the words credit and debit.

This simple chart shows the standard entry to increase or decrease the value in each type of account.



How church accounting differs

The fundamentals covered in the last section are largely universal for churches, other non-profits, and businesses. The differences emerge when we compare how the basics are put in motion. Companies want to turn profits, so their accounting systems are adjusted to track that goal. Churches, conversely, apply their funds to the mission and operation. Your accounting system, therefore, must focus on accountability and transparency. The journey of every dollar donated or raised should be easily explained.





Compliance matters

Accounting is bound by rules and methodologies that control the processes. These constraints ensure standard metrics can measure every organization. They instill confidence for those investing in (or donating to) an organization that its activity is accurately tracked, measurable, and in step with a set of practices called Generally Accepted Accounting Principles (GAAP).

GAAP aids in governing the definitions, assumptions, and methods used in accounting across all industries. While under no obligation to follow GAAP, it's highly recommended that your organization strives to apply the ideas in your accounting practices.

WHO GOVERNS THE GUIDELINES?

The Financial Accounting Standards Board (FASB), that's who. They establish financial accounting and reporting standards for public and private companies, as well as non-profit organizations. Established in 1973, the board is recognized by the U.S. Securities and Exchange Commission as the designated accounting standard setter for public companies.

GAAP contains ten key tenets, authoritative standards (set by policy boards), and the commonly accepted ways of recording and reporting accounting information. GAAP aims to improve the clarity, consistency, and comparability of the communication of financial information.

Reflect on your organization's current accounting practices as you review GAAP summaries below:

1. Regularity

The accountant adheres to GAAP rules and regulations as their standard.

2. Consistency

Accountants apply the same standards throughout the reporting process, every period, to ensure financial comparability between periods.

3. Sincerity

The accountant provides an accurate and impartial depiction of an organization's financial situation.

4. Permanence of methods

The procedures used in financial reporting should be consistent, comparing the organization's financial information.

5. Non-compensation

Both negatives and positives should be reported with complete transparency and without the expectation of debt compensation.

6. Prudence

This refers to emphasizing fact-based financial data representation not clouded by speculation.

7. Continuity

While valuing assets, it should be assumed the business will continue to operate.

8. Periodicity

Entries should be distributed across the appropriate periods of time. For example, revenue should be reported in the relevant accounting period.

9. Materiality

Accountants must strive to fully disclose all financial data and accounting information in financial reports.

10. Utmost good faith

Derived from the Latin phrase *uberrimae fidei* used within the insurance industry. It presupposes that parties remain honest in all transactions.

SELF-CHECK

How would you rate your church's current GAAP adherence? What are you doing well? What could be improved? Use the space below to note your responses.

When it comes to GAAP, my church...

[illegible]

IRS REQUIREMENTS FOR CHURCHES

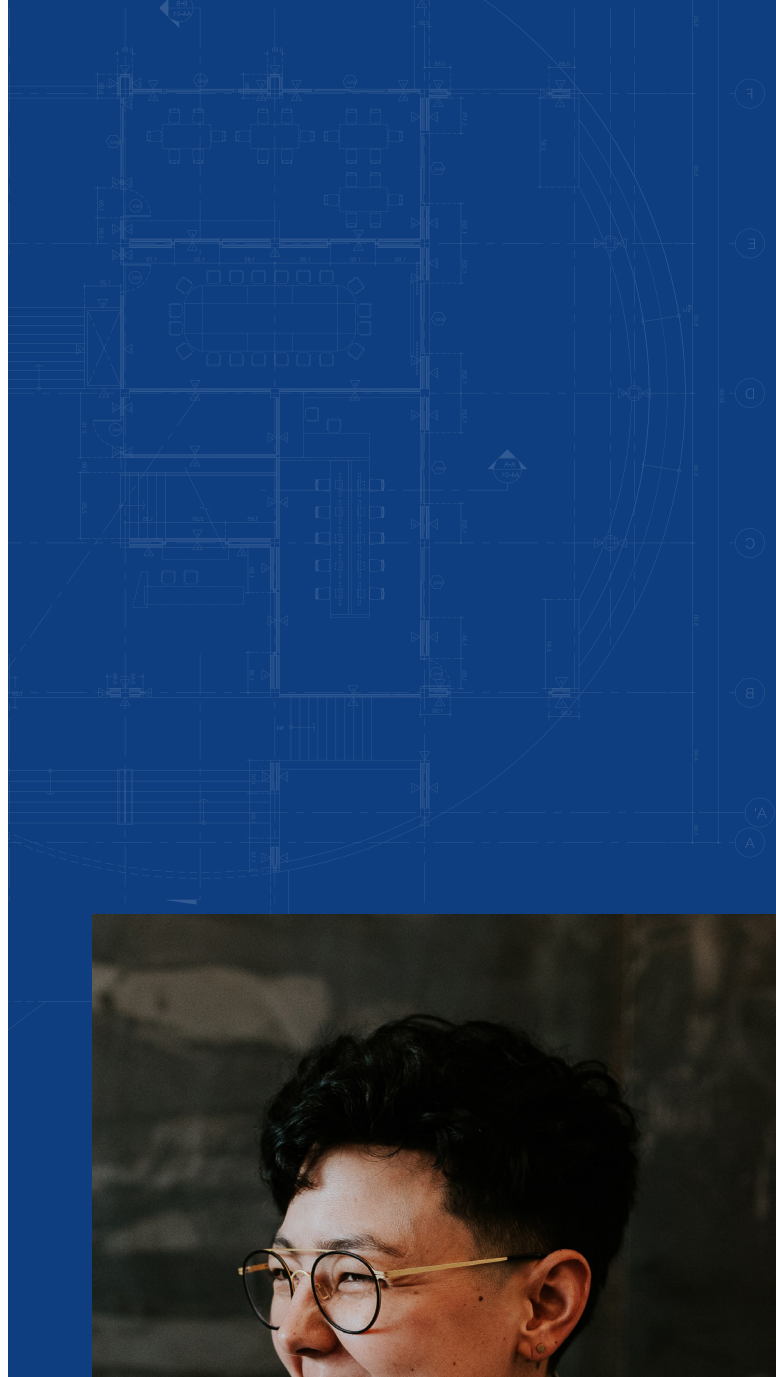
While GAAP provides the guidance your accounting should strive for, the IRS offers its own regulations that **must** be followed. The penalty for not complying with their requirements can be severe and jeopardize the future of your church.

In this overview, we summarize two specific areas: your church's tax-exempt status and related filing requirements. What follows won't be in-depth explorations of each. If you need specific details or want to expand your understanding, we advise you to visit the IRS knowledge base for churches or speak with a local tax professional.

Tax talk isn't known for being riveting, so we'll do our best to cover the must-knows with a light touch.

THE BENEFITS OF A TAX-EXEMPT STATUS

A church is tax-exempt automatically if it meets specific IRS requirements. As such, there are no mandates for the church to seek an IRS-recognized tax-exempt status. But that doesn't mean you should abandon all efforts for its recognition. Pursuing an official tax-exempt status legitimizes your organization in the public's eye and brings some beneficial breaks (beyond tax exemption) to bolster growth.



There are different classifications, but the one most commonly related to churches, synagogues, mosques, and other places of worship is the **501(c)(3)** status. Like all things IRS, this status is defined by a nest of specific situations. Why would a church pursue this status if it's not legally required? Here are some reasons to consider:

- Because 501(c)(3) organizations are required to file a tax return annually, you're again building trust with the community by being transparent about the organization's financial handling.
- Your church may be able to cut costs thanks to the discounts and benefits that align with the tax-exempt status.

- At a local level, your state may provide additional benefits or discounts, which helps funnel more funds into growing the church rather than paying them to taxes.

Contributions to political campaign funds or public statements of position (verbal or written) made on behalf of the organization in favor of or in opposition to any candidate for public office violate the prohibition against political campaign activity.

Violating this prohibition may result in denial or revocation of tax-exempt status and the imposition of certain excise taxes.



EVEN IF YOU’RE TAX-EXEMPT, YOU MAY STILL OWE TAXES

Income generated by so-called “unrelated business” is taxable on anything earned over \$1,000. To be considered unrelated business income, the activity must meet these IRS qualifications:

- **From a trade or business**
Trade or business generally includes any activity carried on to produce income from selling goods or performing services.
- **Regularly carried on**
Business activities of an exempt organization ordinarily are considered regularly carried on if they show frequency and continuity and are pursued like comparable commercial activities of nonexempt organizations.
- **Not substantially related to charitable, educational, or other purposes of the exemption basis**
Determining whether a business activity is substantially related requires examining the relationship between the activities that generate income and the accomplishment of the organization’s exempt purpose.

Is there income being generated by an unrelated business in your church? If so, how much?

WHAT ABOUT AUDITS?

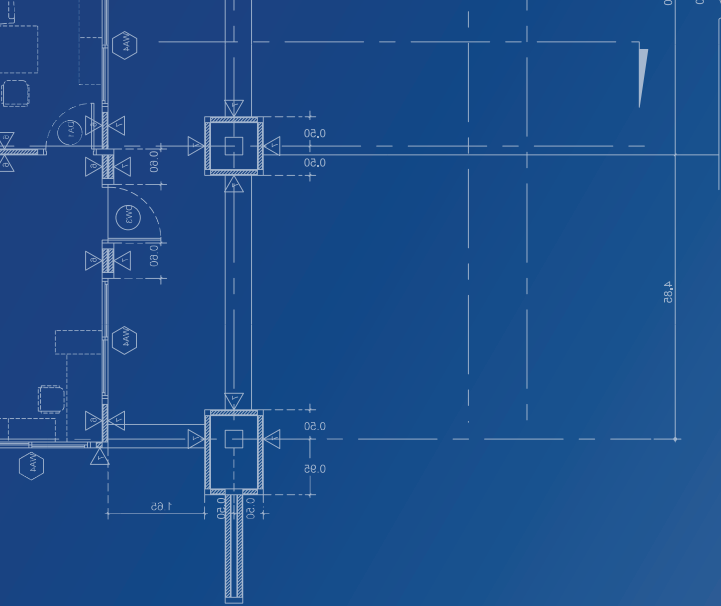
Notable limitations dictate how and when the IRS conducts tax inquiries/examinations of churches. Per the IRS “Reasonable Belief” Requirement, “The IRS may begin a church tax inquiry only if an appropriate high-level Treasury official reasonably believes, based on a written statement of the facts and circumstances, that the organization: (a) may not qualify for the exemption; or (b) may not be paying tax on unrelated business or other taxable activity. This reasonable belief must be based on facts and circumstances recorded in writing. While audits aren’t common for churches, that shouldn’t in any way pave the way for dishonest, fraudulent, non-compliant accounting.

These are merely highlights of a much denser topic. Your tax-exempt status has many benefits, but a great deal of care is needed to maintain it. Consult a tax professional with questions about your church’s specific IRS requirements.

SELF-CHECK

What questions do you have about your church’s tax status or filing requirements? Write them below so you can research them later.

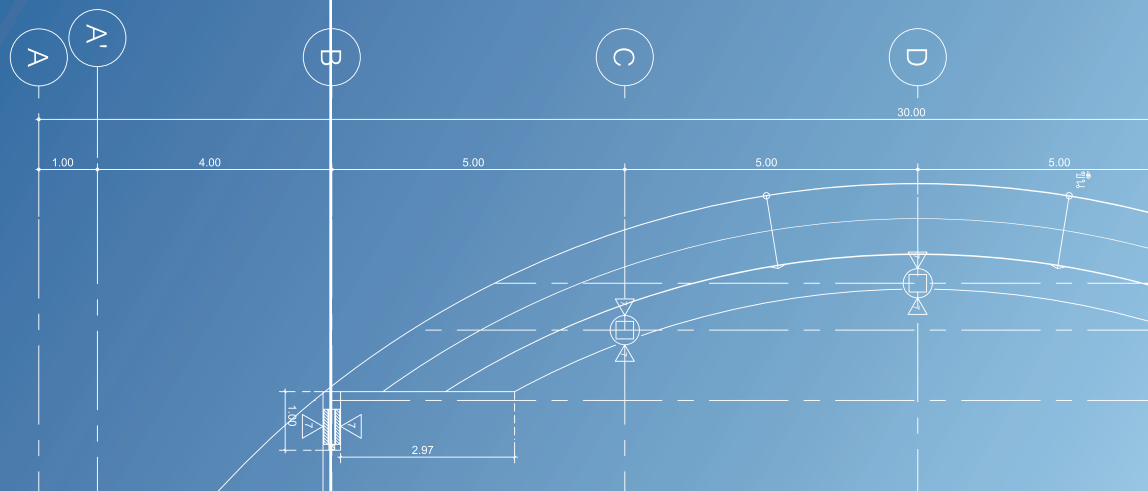
I want to know more about...



CHAPTER 1

Key takeaways

Before we move into best practices, take a moment to review these key takeaways about church accounting.



CHURCH ACCOUNTING IS DIFFERENT THAN FOR-PROFIT ACCOUNTING

They share fundamentals, but a church's unique classifications require industry-specific knowledge to perform it correctly.

- ☒ Be mindful of your IRS status and requirements

CHURCH ACCOUNTING CHALLENGES, REGULATIONS, AND PRACTICES REQUIRE INDUSTRY-SPECIFIC KNOWLEDGE

As a tax-exempt entity, your church must adhere to a unique set of regulations and processes to avoid fiscal backlash.

- ☒ Familiarize yourself with accounting terms that may be specific to a church's financial process

TRACK ACCOUNTABILITY AND STEWARDSHIP, NOT PROFITABILITY

Your service to the community requires bookkeeping that prioritizes accountability for every dollar received.

- ☒ GAAP dictates the procedural ideals for solid, responsible, honest bookkeeping

SOLID CHURCH ACCOUNTING INCREASES CONFIDENCE, PROVIDES TRANSPARENCY, AND CONTRIBUTES TO GROWTH

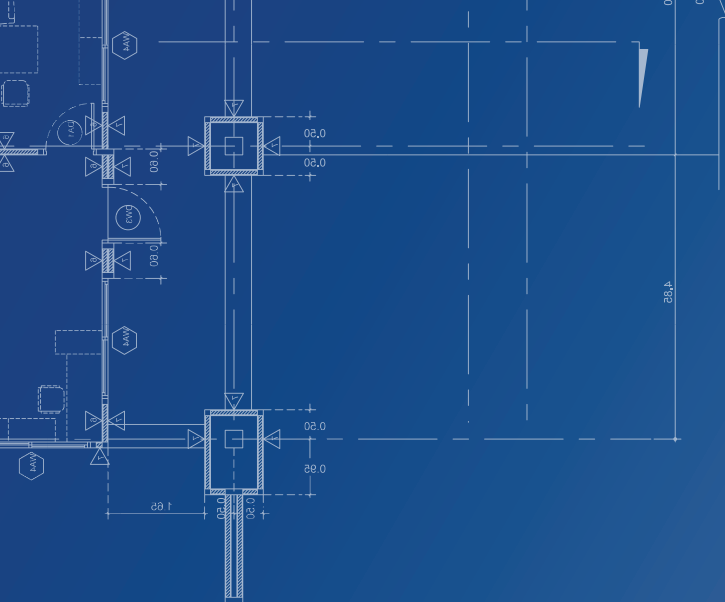
Prioritizing accountability clears the way for instilling congregants' trust that their donations, gifts, and tithes are used appropriately.

- ☒ Growth is a direct result of donors' faith

SELF-CHECK

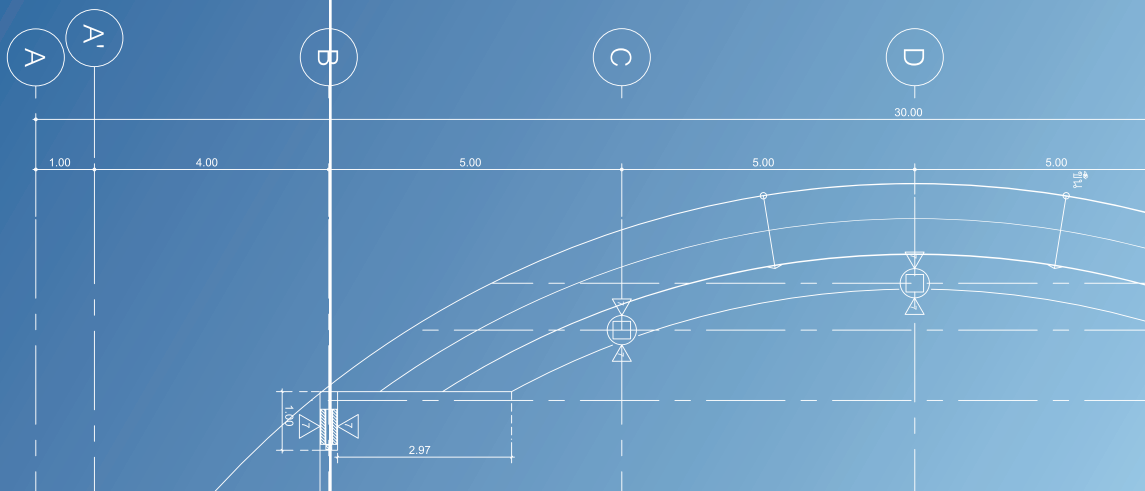
Use the spaces below for questions/topics you'd like to look into about your church's accounting process.

I want to know more about...



CHAPTER 2

Best practices



Now that you've learned what makes church accounting unique let's review some common approaches to your processes. What follows is a series of guides and best practices for managing your church's finance across several areas:

- **General ledger**

Organize the foundation of your entire accounting system

- **Payables/Receivables**

Gain insight into where money is owed by source

- **Bank reconciliation**

Align your activity records to the bank's statement

- **Payroll**

Ensure your employees and contractors are set up according to regulation

- **Financial reports**

Increase awareness and transparency about your church's activity

Use the information from this chapter to review your current approach and identify aspects that could be strengthened to produce a more robust financial snapshot of your church.



Your general ledger check-up

As a keystone of an accounting system, the general ledger can be considered the leading indicator of your church's financial health. It reflects all of your accounts and their corresponding numbers/codes. It's a living document that constantly changes with the growth (and perhaps struggles) of your church.

A church's general ledger typically includes its Statement of Financial Position (its assets, liabilities, and net assets) and a Statement of Activity (records of its income and expenses). Keeping it organized and current ensures you're always aware of your church's financial health.

STICK TO A NUMBERING/CODING SYSTEM

Many organizations rely on a similar numbering scheme for each account tracked in their general ledger. Often five or more digits in length, the assigned code represent divisions of the church,

departments, types of accounts, etc. If your church isn't yet doing this, or if the system feels challenging to navigate, refer to the table below to add consistency to your coding system.

NUMBER SEQUENCE	ACCOUNT TYPE / GROUP
1000s = ASSETS	The tangible and intangible items your church owns that have value • Cash/investments • Undeposited funds • Receivables • Prepaid assets • Current assets • Fixed assets • Accumulated depreciation • Other long-term assets
2000s = LIABILITY	Money the church owes to others • Current liabilities • Long-term liabilities
3000s = NET ASSETS	The portion of total assets the church wholly owns (Also tracked as Equity in for-profit businesses)
4000s = INCOME	Money the church receives from its members and the services it provides • Donations and support • Pledges • Grants • Interest
5000s - 9000s = EXPENSES	Money the church spends to maintain its operations • Functional expenses (admin, payroll, facilities/grounds, programs/ministries, etc.) • Non-operating expenses (mission, ministries, etc.) • <i>Ask my accountant...</i> a safe space for unknowns

SET OPENING BALANCES

New accounting systems need a starting value. Each asset, liability, and net asset account will likely have opening values associated with them. Setting their beginning balances provides the amount by which all subsequent transactions are tracked. As part of your year-end reporting, record the balance of each account.

DESIGNATED AND RESTRICTED FUNDS ARE DIFFERENT

They both explain monies with an intended purpose, but that’s where the similarities stop. Some confuse these classifications, which can endanger compliance due to misusing monies. Keep your books straight and out of danger by remembering their different intended purposes.

DESIGNATED FUNDS	RESTRICTED FUNDS
Monies set aside from a general fund for a specific purpose	Monies given, collected, or donated for a specific purpose
These are funds determined by the “board” or leadership to be determined for a particular ministry based on a commitment made internally. (Church decides that they will “tithe” their revenue to other ministries, but they are not legally obligated to do so.)	Funds are given with a predetermined purpose that was chosen by the donor. This is agreed to by the organization (I cannot give you money to spend a certain way unless you have agreed to that), so these funds are restricted to only that use and should only be used for the predetermined or restricted purpose.

BUDGETING PROMOTES GROWTH

Advisors at AGFinancial posted budgeting approaches your church can follow to encourage growth:

- **Focus on 80%**

Base your budgets on 80% of your church's income (its tithes and offerings) and retain the other 20% in reserve.

- **Set goals to close gaps**

Churches usually encounter three gap types: smaller forecasting gaps, more significant faith gaps, and unrealistic gaps. Setting strategic goals to address them can aid in closing them.

- **Save toward goals**

Keep some reserves for unforeseen needs but don't forget to create a plan to make your heart's dreams for the church come true.

- **Monitor progress**

Even the best accounting systems need a watchful eye. Regularly check your balances, expenses, and bank statements for opportunities to adjust as needed.

- **Share the church's vision**

Present your plans and ideas for growth with strategic individuals from the congregation who may be capable of supporting beyond their usual tithes.





Streamline payables and receivables

Bucketed with other liability account categories, your payables and receivables are critical to the church's overall financial landscape. They provide critical insight into where money is owed by its source.

Payables are the monies owed to a creditor by you. That could be a vendor or a supplier. Those working with payables face a delicate balance: paying bills, managing credits/payments to vendors, nurturing vendor relationships, and documenting invoice journeys.

Receivables reflect the monies owed to you for goods and services. It's an equally intricate numbers dance of tracking billing activity and payments obtained.

Both efforts can fall victim to overwhelming, paper-based processes—even when Excel is part of the tracking. Here are some additional ways to make payables and receivables less cumbersome.

WHO PAYS THE PROCESSING FEE?

If your church allows credit cards for payment, determine if the processing fee should be added to your invoices. Let's say your credit card transaction fee is 2.4%, and you're invoicing someone for \$120. The balance due would be \$122.88. Doing so nets the church \$120, and the invoice recipient covers the processing costs. Over time, this could add up.



CHOOSE (AND STICK TO) AN ACCOUNTING STRATEGY

You can follow two schools of thought when setting your accounting strategy. Picking one focuses your processes and attention. One may better fit your church’s current situation than the other.

CASH METHOD	ACCRUAL METHOD
Based on the inflows and outflows of cash. Income and expenses are recorded as they are received, instead of when they’re earned. It’s a comparable approach to managing personal finances. Though limited, it can be a simpler strategic direction.	Based on when revenue is earned and when expenses are incurred. The approach makes room for complex details in your financial documents (accruals, allocations, payables, receivables, outstanding obligations, and pledges). Accrual accounting requires two entries per transaction and a constant eye for when adjustments are needed. Though more complex than a Cash strategy, you gain greater visibility into what’s happening.

GOOD RELATIONSHIPS LEAD TO GOOD DISCOUNTS

Staying in your vendors’ good graces can open the door to savings. Many offer discounts for early payment, being a long-time customer, item quantity breaks, and more. The first step toward uncovering deals is maintaining a positive

relationship with your chosen vendors. If you’re seen as a problem child of their customer base with constantly mismanaged invoices and late payments, the door of opportunity will remain closed.



Bank reconciliation: Checks for balances

As you may have assumed, your bank also tracks your church's activities. In a digital age, when you can tap an app and see your account balance, it's easy to disregard a monthly bank statement. Ensuring your records and the bank's balances align confirms the money you think you have is still correct.

Bank reconciliation is the process of performing that check. You compare the bank's statement of accounts against the church's income records (collected and banked) and approved expenses. Thorough reviews can uncover needed corrections or initiate further investigations.

ESTABLISH YOUR RECONCILIATION PROCESS

It's manual. It's time-consuming. It's not exciting. Yet, regularly performing bank reconciliations will help prevent future headaches when anomalies are found. If you're new to the process, here are some tips to remember:

- ✓ Get the ink out. Literally, check off each line item you review in the statement that lines up. Anything that isn't checked off can be the focus of further review.
- ✓ Your statement may contain direct transactional activity, including direct transfers to the church's bank or merchant receipts from card-paying donors. These are a low risk for being outliers of your reconciliation process. Add them to your accounting system when performing your reconciliation.
- ✓ Bank interest and charges first appear in your bank statement. Record them when they show up as line items.
- ✓ Track the reconciliation in a spreadsheet to maintain historical visibility, or seek a software solution that includes this process in its features suite.

PERFECTING YOUR RECONCILIATION PROCESS

Here are some ways to fine-tune your regular bank statement reviews:

- ✓ Good controls over income and expenditure, including recordkeeping, contribute toward success.
- ✓ Bank income intact (donations counted, bagged, and banked) without holding any amount for any purpose. Then immediately record the deposit into your accounting system.
- ✓ Enact a standard authorization and recording process for all expenditures. Include the date, amount, items purchased, financial authorization, supporting documentation, and payment information for every expense.



Getting rolling with payroll

Welcome to what will be the densest section of this chapter. Payroll is tricky on many levels. Numerous and constantly changing federal and state laws make things challenging to manage on your own. It gains complexity because the mix of individuals on your payroll (employees, contractors, volunteers, ministers, etc.) require varying degrees of recordkeeping.

In a section devoted to providing best practices, the simplest answer for payroll management is to hire a knowledgeable service to do it for you or invest in a software option designed specifically for church accounting. Regardless of your direction, you must know how to add workers to your accounting system correctly to mitigate potential penalties for incorrect filing.

Note: Our focus below is on federal requirements. Your state and local governments may have additional labor and tax guidelines to consider. Connect with a community expert to ensure you've covered those bases in your payroll.

PAYROLL 101 CHECKLIST

ESTABLISH YOUR CHURCH'S TAX ID

- ☐ Request an EIN [IRS Form SS-4]
- ☐ Request your state and local ID numbers (as required, contact your state's revenue department for requirements)

CATEGORIZE YOUR WORKERS

- ☐ Identify independent contractors – they will not need employment taxes withheld
- ☐ Identify full and part-time employees – they will need employment taxes withheld

DETERMINE PAYROLL PERIOD

- ☐ The frequency is up to you (weekly, bi-weekly, semi-monthly, monthly, etc.), but it should be consistent with set paydays

NEW EMPLOYEE FORMS

- ☐ Ensure you have a W-4 for every employee. Everyone must fill out Form W-4 to report desired allowances and tax withholding preferences. Keep in mind:
 - If you don't have one on file for an employee, that individual must be treated as a single person with no exemptions
 - Your state may have its own exception certificate form, review its local tax/labor laws
 - Major life changes or desires to alter withholdings require an employee to complete a new W-4. **Note:** The W-4 changed formats in 2020, and existing employees making changes to their W-4 must use the most current format.

- Employees are permitted to request additional tax withholdings using line 6 of their W-4:
 - Because of their dual status (an employee in the fed's eyes, self-employed in the eye of Social Security/Medicare), your minister(s) could request additional withholdings to cover self-employment tax. See *the Clergy Tax* section below.
- For all employees (excluding ministers), you must match and withhold FICA (Federal Insurance Contributions Act) tax. The exception is if your church has exempted itself from making these payments by filing an IRS Form 8274 (Certification by Churches and Qualified Church-Controlled Organizations Electing Exemption from Employer Social Security and Medicare Taxes).
- Churches are exempt from paying federal unemployment tax. Check with your state's unemployment tax agency to confirm if exemptions are granted for your church.
- Churches are required to provide Workers' Compensation in many states. Confirm your state's requirements.
- If your church is in California, Hawaii, New Jersey, New York, Rhode Island, or Puerto Rico, you must withhold and/or pay taxes that fund the state's temporary disability insurance program. Confirm your state's requirements.

- [] All hires must fill out Form I-9 to verify identity and employment authorization.

Please note that Form I-9 is:

- Completed with input from the new employee and you, the employer
 - Required for every employee (both citizens and non-citizens)
 - Retained for three years after an employee hire date or one year after termination (whichever is later)
- [] Report all new employees within 20 days (or sooner, depending on local requirements)

NEW CONTRACTOR FORMS

- [] Completed W-9 form. A good practice is to have every vendor providing services to the church complete a W-9.

ESTABLISH PAYROLL RECORDS

- [] Collect and record the following to comply with federal requirements:
 - Name, address, and Social Security Number of each employee
 - Total amount and date of each payment
 - Portion of each payment that constituted taxable wages
 - Copies of each employee's W-4
 - Copies of returns you filed
 - Copies of any undeliverable W-2 forms
- [] Calculate payroll taxes and withholdings, including:
 - Federal tax withholdings - refer to IRS tax table Circular E for correct amounts



- State/local tax withholdings - refer to your state and local tax tables for correct amounts
 - Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington, Wyoming do not impose personal income tax

PREPARE AND FILE PAYROLL TAX RETURNS

- [] Prepare IRS Form 941 quarterly, per the following schedule:

- Q1: end of April
- Q2: end of July
- Q3: end of October
- Q4: end of January
- Your state likely has its own payroll tax forms that must be completed and filed. Confirm your local requirements.

- [] Prepare an annual W-2 in January for each employee to report how much they made and their withholdings



CLERGY TAX

U.S.-based ministers qualify for a unique tax situation that should be known when setting them up in your payroll. As discussed above, they pay self-employment tax. They are also entitled to housing allowances, and the church cannot withhold FICA tax from their paychecks.

Even if you're using a payroll service, they may not know how clergy tax works. We've summarized the must-knows but highly encourage you to consult a tax professional with church accounting experience for answers to specific questions.

DETERMINATION OF CLERGY TAX CLASSIFICATION

To qualify for this status, the individual must be licensed, ordained, or commissioned, then:

- Administer sacraments of the church
- Considered a religious leader by the church
- Conduct worship
- Have management responsibilities in the church

Note: Pastors are almost always considered clergy for tax purposes.

SELF-EMPLOYMENT TAX MUST-KNOWS

In most circumstances, the minister's income subject to the self-employment tax includes the base salary, the housing allowance, and the fair rental value of church-provided housing if any.

EXAMPLE

\$32,000 (base salary)

\$14,400 (housing allowance)

$\$46,400 \times 15.3\% = \$7,048$ (Does not include the minister's income tax)

- Clergy pays self-employment tax, and can request to have additional withholdings applied to cover it
- They pay Social Security and Medicare through the Self-Employment Contributions Act (SECA), not FICA
- The church cannot withhold half of the Social Security and Medicare taxes from the minister's paycheck
- Your minister employees actually pay twice as much Social Security and Medicare as non-minister employees
- Additional tax notes
 - The church CAN'T withhold FICA from a qualifying minister's compensation
 - The church CAN withhold income tax at the minister's request

OPTING OUT OF PAYING SOCIAL SECURITY

A qualifying minister can opt out of paying Social Security. It must be done using IRS Form 4361 by the second year they earn \$400+ in ministerial income.



A faint, light blue architectural floor plan of a church building is visible in the background of the left half of the page. The plan shows various rooms, including a large sanctuary with pews, a smaller room with a table and chairs, and several restrooms. Dimensions and room numbers are scattered throughout the plan.

Financial reports

Your records contribute to the church's transparency. By providing an accurate account of its overall financial health, you help build trust within the community. In turn, that trust translates to donations, tithes, and offerings from the community. Your financial reports echo to donors (and government agencies) that their gifts are being utilized appropriately.

The complexity of reporting needs depends entirely on your church's current financial situation. Whatever complexity you face, the core reports mirror the same ones you'd see in a for-profit business.

ACTIVITY REPORT

This statement details the revenue and expenses of your church.

- Income includes monies received, members' gifts, interest gained on invested monies, and other sources
- Expenses include utilities, rent, maintenance, and wages—anything needed to keep the church in operation
- $\text{Income} - \text{Expense} = \text{Net income}$

STATEMENT OF FINANCIAL POSITION

Also known as a balance sheet, this statement details the assets and liabilities of your church. It's not as common in smaller churches that don't (yet) owe on buildings or other significant liabilities.

- Assets include cash, investments, insurance policies, buildings, etc.—they are items the church owns
 - $\text{Assets} = \text{Liability} + \text{Net Assets}$
- Liabilities include loans the church takes out, buildings, etc.—monies the church owes

CASH FLOW

This statement details the origin and application of all cash. It's primarily part of a larger church's financial report group and used to communicate where/how they spent cash on various activities (missions, soup kitchens, school, anything outside of typical church operation).

YOUR MONTHLY TO-DO LIST

Ensure the following activities and financials are compiled monthly:

- **Church introduction**

Provide an overview of who you are as an organization, the period you're reporting on, and what will be reported

- **Membership details**

Provide insight into how the congregation is growing in terms of its people base

- **Activities**

Explain how monies received were utilized over the month

- **Highlights**

Showcase some of the biggest wins for the church during the month

- **Funding details**

Record how much money was raised / donated by the church

TAX REPORTING ON UNRELATED BUSINESS

Churches are tax-exempt. However, you do have to file and pay income tax on activities categorized as unrelated business (see IRS Tax Reporting section above). You may also need to fill out employment tax forms. Always consult your local tax/revenue department for state-specific requirements.

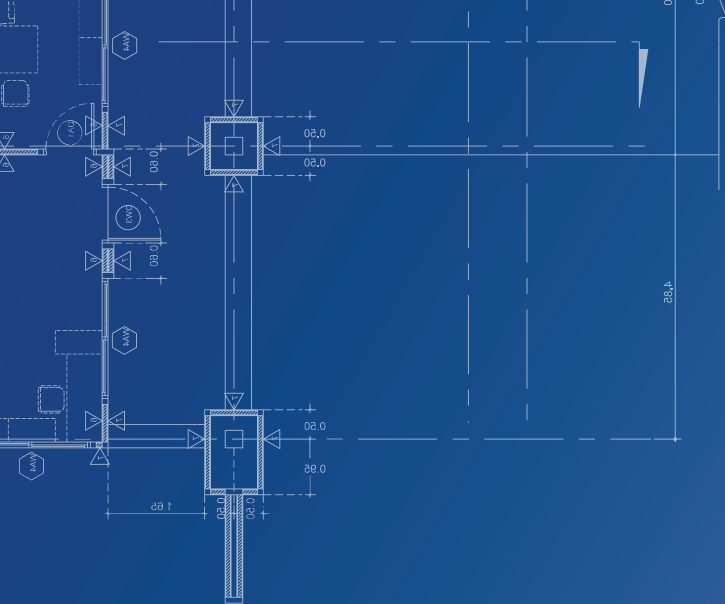


FINANCIAL REPORTING BEST PRACTICES

- Make them easy enough to read so that anyone can understand the church's current financial situation
- Be direct and factual, so reviewers don't get lost in unnecessary details
- Provide comparison information (budget, data, etc.) from the same period of the prior year
- Be diligent about preparing reports every month and as quickly as possible

BUDGET REPORTING

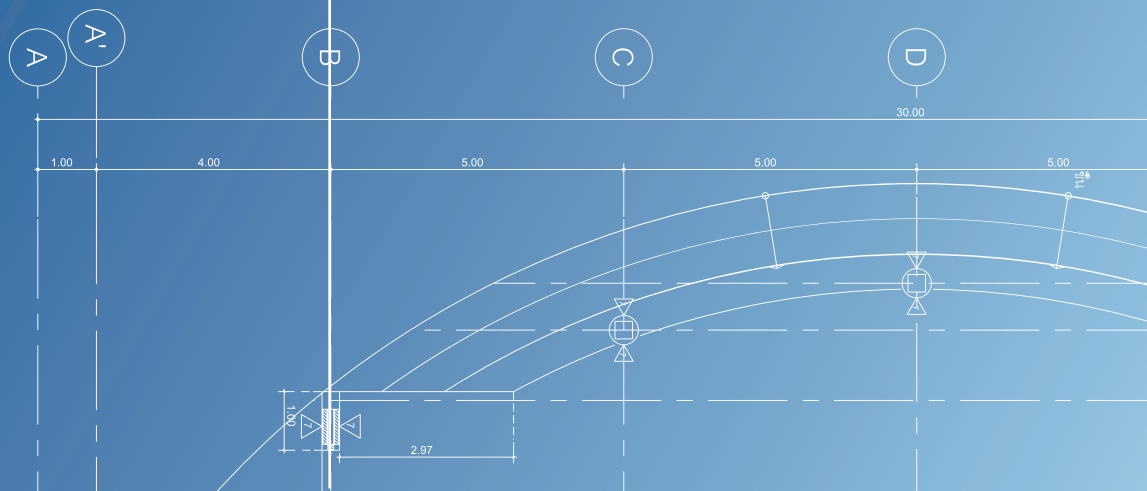
It is essential to track actual activity compared to budget (or planned activity). Budgeting is essential to set long-term goals and to ensure your success in reaching those goals. Comparison of actuals to budgets are best checked monthly and cumulative or year to date. Budgets can be set annually or split evenly over each period for things such as mortgage payments or standard and static fees, or they can be set by period to account for fluctuations during the year for seasonal events or payments. This is not a required report according to GAAP, but it is very good practice and a key to setting and achieving goals.



CHAPTER 2

Key takeaways

Compare the best practices from this chapter to your current approach and identify aspects that could be strengthened to produce a more robust financial snapshot of your church.



AN ORGANIZED GENERAL LEDGER ENSURES YOU'RE ALWAYS AWARE OF YOUR CHURCH'S FINANCIAL HEALTH

- ☒ Establish and standardize a numbering/coding system
- ☒ Set opening balances
- ☒ Be mindful of designated and restricted funds
- ☒ Budget for growth

PAYABLES AND RECEIVABLES ARE CRITICAL TO THE CHURCH'S OVERALL FINANCIAL LANDSCAPE

They provide invaluable insights into where money is owed by its source.

- ☒ Choose and stick to an accounting strategy (i.e., cash or accrual method)
- ☒ Cultivating good relationships with vendors can result in discounts

BANK RECONCILIATION TAKES EFFORT BUT IS WORTHWHILE

It ensures your records and the bank's balances align and confirms the money you think you have is still correct.

- ☒ Begins with accurate opening balances
- ☒ Establish and standardize a reconciliation process

PAYROLL IS COMPLEX AND FREQUENTLY CHANGING

- ☒ Numerous federal and state regulations/requirements make payroll challenging to perfect

- ☒ Rely on the Payroll 101 checklist (page 28) for help navigating the basics

YOUR FINANCIAL REPORTS ARE CRITICAL

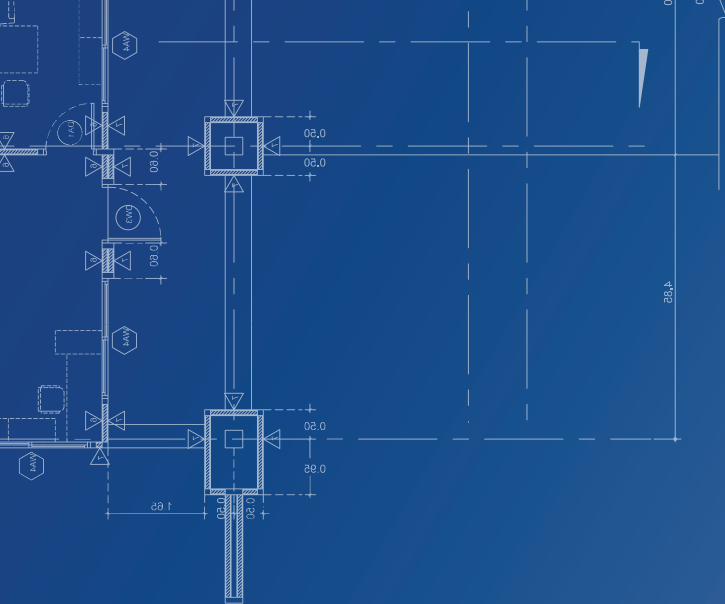
They provide an accurate account of your church's overall financial health and build trust within the community.

- ☒ Activity report - your church's revenue and expenses
- ☒ Statement of financial position - your church's assets and liabilities
- ☒ Cash flow - the origin and application of the church's cash
- ☒ Churches don't typically file tax returns, but certain cases (like unrelated business activities) may need to be reported
- ☒ Consult a tax expert with specific questions you may have
- ☒ Comparison of actuals to budgets are best checked monthly and cumulative or year to date

SELF-CHECK

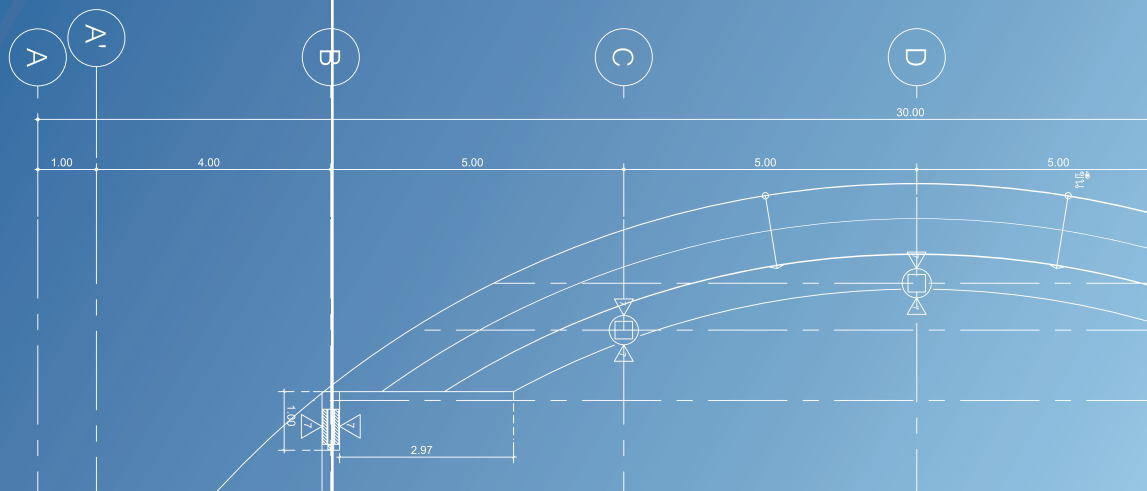
Use the spaces below for questions/topics you'd like to look into about your church's accounting process.

I want to know more about...



CHAPTER 3

Choosing accounting software





As the last chapter explored, there's a lot to remember when bookkeeping for your church. It's not uncommon for the manual processes and time-consuming busywork to overwhelm a finance team. Many turn to software solutions to streamline, simplify, and enhance their finance processes.

Adding technology and the fear of changing processes you've relied on for so long can intimidate a church of any size. The right solution makes the transition seamless and becomes a tool that supports future growth. Additional benefits of making the switch include:

- **Save time and money**

A more efficient process that's less prone to error has a direct impact on your finance team's workload and cost of operation

- **Manage finances from anywhere**

Access the same dashboards and approval flows from any network-enabled device

- **Potentially using your existing accounting system**

Moving to a new solution doesn't have to mean abandoning the system you already use

- **Improve vendor relationships**

Timely payments and improved invoice awareness pave the way to happier vendors, some of which offer additional discounts for their preferred customers

- **Expand financial visibility**

Imagine having fast, accurate, consistent awareness of the church's financial health

- **Take the guesswork out of goal setting**

Base the church's growth goals on factual financial data and trends

- **Ease frustration for everyone**

From expense submitters to approvers, everyone who contributes to the church's financial processes will welcome a simpler, intuitive workflow that allows them to focus on more important service needs

Making the switch requires a comprehensive comparison. This chapter provides the foundational elements your church should look for when considering its accounting software solution investment.

Plan before you invest

If it's time for your church to pursue an accounting software solution, you'll do yourself (and anyone helping with the transition) a favor by taking a systematic approach. There are numerous options out there. Knowing your situation and specific needs makes picking the right solution much more manageable.



- **Set a budget**

Have a realistic understanding of how much the church can invest in its chosen solution.

- **Identify your team**

Most solution implementations will require resources from several areas of the church (accounting, leadership, IT, and more).

Knowing who in your organization can commit to helping makes the switchover less hectic.

- **Identify your must-haves and most-wants**

The investment in accounting software should improve your current processes. Get input from everyone in the organization about essential features and capabilities. Also, ask them to list things they wish a new solution could provide. Are you just looking for an accounting platform? Would you prefer an all-in-one church services solution capable of organizing every aspect of your house of worship's service to the community?

If you need help formulating a list of needs, we've provided a list of essential comparison criteria in the next section.

- **Talk to your peers**

Rely on the experiences and selections fellow church accounting peers made to inform your choice. In addition to the insight into a solution's features, your peers can give first-hand perspective about what it's like to use a solution and their ability to support it when needed.

- **Narrow the list and test drive**

Condense your options to two or three strong contenders that align with your budget, needs, and promise to improve the church's finance workflows. Invite your identified team members to assist with test driving to get their opinions, too. This investment will impact everyone in the organization (hopefully positively), so stress test every conceivable situation—from basic tasks to urgent support needs—while demoing your narrowed list.



Refine your search criteria

Though they promise to make accounting easier, not all solutions are created equal. Some are just the wrong choice, like QuickBooks, and cause more frustration than anything because they weren't designed for a church's unique accounting needs. The wrong choice could also increase the risk of financial foul play. Concentrate your solution comparison on these accounting elements to make the best choice.

GENERAL LEDGER

It's the backbone of your accounting, so choose a solution that makes creating transaction subgroups easy, simplifies the entry/tracking process, and provides a clear/concise view of your church's financial health.

Does the selected solution:

- Provide a flexible account structure for a customized chart of accounts and reports?
- Include department worksheets to simplify their processes?
- Enable automatic deposits from member contributions and pledge postings?
- Deliver non-profit reporting that reflects the church ministry?

PAYROLL

Take the hassle out of payroll for your church staff. Choose a system that manages all aspects of your payroll. Can it provide gross wage computation, calculate all necessary taxes, withhold voluntary deductions, print a payroll check for the employee, and provide necessary totals for monthly, quarterly, and annual government and management reporting, including e-File reporting?

Does the selected solution:

- Guide you and your users step-by-step through the payroll process?
- Handle special clergy allocations and benefits?
- Save costly checks by printing direct deposit receipts on standard copy paper?
- Satisfy all of your data needs with a versatile reporting system?

RECEIVABLES

Choose a solution that accurately reflects your actual financial position if receivables are connected to your chart of accounts. Tracks payments for various sources such as church daycare and school tuition—tracks billing activity for church headquarters, collecting insurance, pension, and apportionments.

Does the selected solution:

- Streamline processes, thus leading to a boost in productivity?
- Provide features and tools that make managing receivables effortless?
- Focus its workflow on your central chart of accounts?

PAYABLES

An accurate fund accounting system will help your church gain instant access to the financial information you need. Simplify how you pay bills, manage credits from and payments to vendors, and attach invoices and other documentation—flexibility to operate on a cash, accrual, or modified accrual basis.

Does the selected solution:

- Offer secure access anytime, anywhere via a network-connected device?
- Allow you to set user permissions based on their function and/or fund?
- Back up data automatically and push software or tax table updates?



REPORTING

Having access to financial reports is extremely important for churches because they have a wide range of donors, pastors, and financial councils that need to view such reports. Your selected software must provide general ledger standard monthly reports and an easy-to-use, custom presentation report builder. Look for solutions that provide drill-down functionality back to a single application entry within your general ledger reports. Reports should be downloadable in several formats.

Does the selected solution:

- Alleviate the stress of providing financial statements?
- Allow instant access to your church financial reports from any network-connected device?
- Provide the core financial reports you need, and the ability to craft ones unique to your situation?

INTEGRATION

Reduce the number of errors caused by manual data input. Reconcile contributions and receipts with online giving and accounting. Track your members and donations in a comprehensive, easy-to-use system. Be an excellent steward of your two most valuable resources: people and finances. Streamline complicated processes and save valuable time.

Does the selected solution:

- Speak with your other accounting system effortlessly to provide a full view of your church's finances?
- Streamline your existing accounting processes and scale as your church community grows?
- Centralize your systems so you're not wasting time chasing answers from different platforms.



Additional features that matter

AUTOMATION

No one invests in a software solution hoping to make things harder. Automation, done right, can radically transform accounting and finances. Everyone involved, from congregants to ministers, should enjoy a greater sense of ease from the simplicity automation delivers.

ACCURACY

Data input using pen/paper or Excel is prone to human error. A software solution's built-in intelligence and error-checking dramatically increase the accuracy of your finances.

APPROACHABILITY

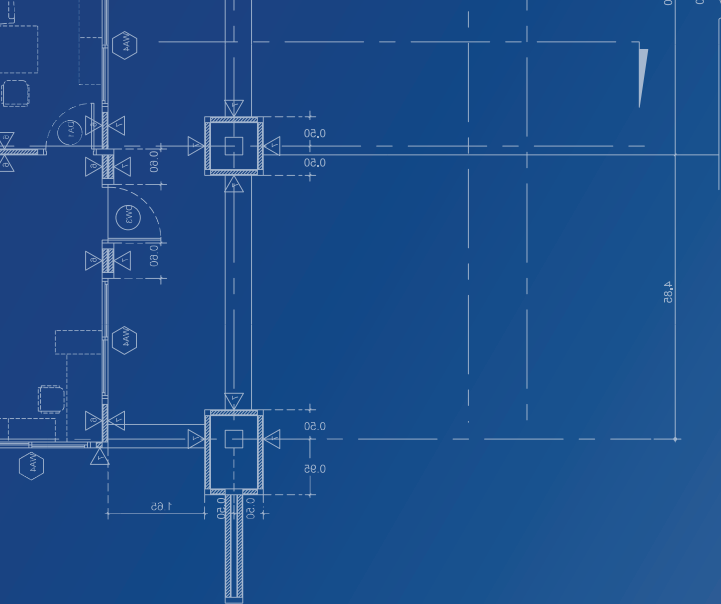
Change can be difficult, whether it's your first time working with a software solution—or transitioning to a new solution provider. Reduce the frustrations by getting a true sense of a software's approachability. Invite people with mixed technology aptitudes to demo solutions for their potential fit in your organization.

COMPLIANCE

The right solution fulfills your financial requirements for governing boards, financial committees, internal staff, and outside agencies. It takes the guesswork out of your current level of compliance and makes it easier for everyone to understand and maintain compliance.

E-FILING

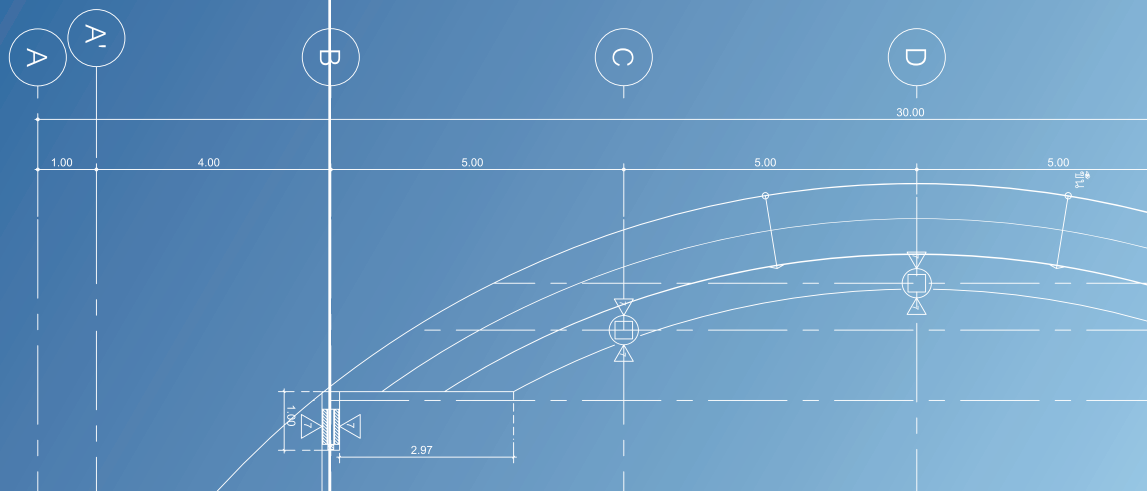
Extend the ease and time-saving to your contract and on-staff workers through e-filing for required documents. Usually, the added capability incurs a small, reasonable fee. In the long run, it maintains accurate, consistent documentation of all forms submitted to federal and state/local governments.



CHAPTER 3

Key takeaways

Many churches are turning to software solutions that streamline, simplify, and enhance their finance processes.



**THE RIGHT SOLUTION MAKES
CHANGE SEAMLESS AND SUPPORTS
GROWTH**

Adding new technology doesn't have to be an intimidating effort and can deliver newfound ease across the organization.

- ✓ Save time and money
- ✓ Manage finances from anywhere
- ✓ Improve vendor relationships
- ✓ Expand financial visibility
- ✓ Take the guesswork out of goal setting
- ✓ Reduce process frustration

DILIGENT RESEARCH HELPS MATCH YOU WITH THE RIGHT SOLUTION

- ✓ Knowing your situation and specific needs makes picking the right solution much more manageable
- ✓ Set a budget
- ✓ Get feedback from users and administrators at all levels
- ✓ Identify your must-haves and most-wants
- ✓ Get your peers' input
- ✓ Narrow your list and demo for the perfect fit

**PICK A SOLUTION DESIGNED
SPECIFICALLY FOR CHURCH
ACCOUNTING**

There are a lot of options to choose from, but many are not built to handle the unique aspects of church bookkeeping.

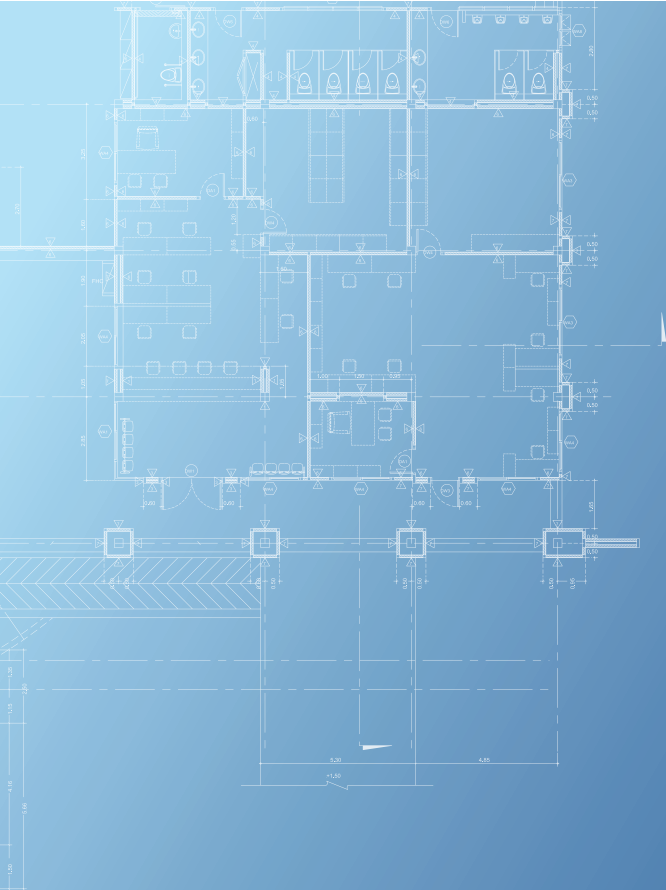
- ✓ Rate prospective solutions on their ability to enhance how you manage the general ledger, payroll, receivables, payables, and reporting
- ✓ A robust solution makes life easier, improves accuracy and compliance, and is approachable by users

SELF-CHECK

Use the spaces below for questions/topics you'd like to look into about your church's accounting process.

I want to know more about...

[illegible]



Ministry Brands

ministrybrands.com

