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Expert Analysis

Ensuring Proper Financial Oversight for Religious Organizations

By Barry Black & John B. Madden

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Much as religious organizations are spiritual bodies granted unique protections behind the venerable wall of separation between church and state, they are also temporal entities subject to the same types of secular laws that govern traditional corporations. Church corporations are businesses. They need to raise, conserve, and wisely spend funds to further their not-for-profit purposes. As such, it is imperative that they implement and maintain a reliable mechanism for financial governance. The lack of adequate oversight can swiftly lead an organization into instability and endanger its continued viability.



By Barry Black



And John B. Madden

This column will consider some of the fundamentals of financial governance to which all religious organizations should adhere. Familial as church bodies may naturally tend to be, financial integrity is as crucial for the assurance of legal compliance as it is for the provision of good stewardship for sacred funds.

Putting the Right People in Charge

Proper financial oversight starts with securing qualified individuals with the requisite skill and experience to run an organization's finances. Many churches will elect a board of trustees, which will in turn select officers, including at minimum a president, a treasurer, and a secretary, to direct and guide its governance. The treasurer must, by virtue of the position's basic requirements, have a background in and significant comfort with financial matters such as accounting, bookkeeping, or banking. But all officers should ideally have basic familiarity with financial fundamentals. While the treasurer will ultimately be responsible for spearheading a religious organization's

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finances, it is often important to establish a finance committee. Headed by the treasurer, the committee can envision, establish, oversee, and enforce a smart and effective system for financial governance.

Nowadays, certain aspects of a church's finances can be successfully outsourced. With the digitization of certain professions, accounting, bookkeeping, and other firms have captured significant market share in providing churches with off-premises financial services. With the increase in awareness of the need to be financially compliant, many faith-based organizations choose to lean on these outside professionals who are highly experienced in the unique ins and outs of church tax, finance, and accounting, while saving costs associated with overhead, education, and training. This approach can ease the burden of establishing appropriate mechanisms while strengthening oversight and enforcement.

Adopting and Enforcing Appropriate Policies and Procedures

Beyond having the right team in place, religious organizations should also adopt comprehensive financial policies and procedures, which lay out clear standards and expectations. Considering the detail involved in creating financial policies, they should be updated periodically, to reflect the organization's growth as well as changes in relevant rules and regulations. The policies thus support and provide practical depth for the organization's bylaws.

Financial policies are usually adopted by the board of trustees, which is ultimately tasked with assuring that the policies are meaningful, workable, and reflect the corporate mission. As is the case with most aspects of a church organization, doctrine and spiritual traditions affect even its most mundane facets, like financial management.

Financial policies should clearly outline procedures for developing and modifying the budget, establishing spending limits and approval requirements, managing donations, determining who has authority to access bank accounts and sign checks, maintaining records, and addressing conflicts of interest. For example, donorfund procedures may require that at least two individuals review donations on a rotating basis, and that checks above a specified amount carry dual signatures. These policies should also include clear authorization protocols so that leaders and staff understand exactly who is responsible for various financial decisions and approvals.

To support routine expenditures, religious organizations often maintain one or more credit cards issued to specific individuals, such as the minister, treasurer, or other designated officers. For proper accounting and oversight, only the individual whose name appears on the card should make purchases with it. Cards should never be shared, as informal "lending" can create accountability problems for the cardholder and erode trust in the organization's financial practices. Card numbers and other sensitive information should therefore be kept confidential to prevent unauthorized use. Monthly credit card statements should be reviewed and approved by the treasurer or an authorized designee, who must carefully verify the legitimacy of all charges.

Alongside the implementation of sound financial policies, every religious organization should adopt and adhere to a robust conflictofinterest policy. Such a policy helps ensure that officers, board members, and clergy do not maintain undisclosed financial relationships with the organization,

unless the board approves them with full awareness of the circumstances.

Financial Audits

Once sound financial policies and procedures are in place, the next essential step is to create an audit committee to review and evaluate how those policies operate in practice. The board is typically responsible for appointing this committee. Ideally, committee members should have sufficient financial expertise to conduct a meaningful review. Although audit committee members may also serve on the board, they should not hold the positions of minister, treasurer, or president, as this separation helps prevent conflicts of interest. Ultimately, the audit committee serves as an additional safeguard to ensure that the organization's finances are properly managed.

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In addition to establishing an audit committee, every religious organization should also ensure that its financial statements are audited annually by an external independent auditor. This auditor should be selected by the board, on the recommendation of the audit committee.

The auditor will then proceed to give an opinion on the church's financial statements, directed to the board's attention. Such an opinion will either confirm that the financial statements present fairly the church's financial condition or set forth ways in which the financial statements fail to meet relevant auditing standards. In the latter situation, an auditor may also issue a "management letter," addressed to the board, noting the specific issues that should be addressed. While such a letter may fall short of a formal auditor's opinion, it provides an important basis upon which improvements in managing the organization's finances can be made.

Business Expense Reimbursements

An accountable reimbursement plan enables organizations and their employees to reduce the overall tax burden by assuring that relevant employee expenditures qualify as business expenses. Under such a plan, an employee's expenses are not recorded as income on either IRS Form W-2 or 1040 and thus are not subject to income taxation. Enforcing an accountable reimbursement plan means that any reimbursements to the employee are not computed as compensation. Thus, the employee's overall benefit may be enhanced by the employer's expending of tax-free dollars. The collective avoidance of paying additional monies for income taxation increases the overall pool of funds available for employee compensation, even if every such additional dollar is ultimately shared between employer and employee—a win-win for all.

In order to qualify as an accountable plan and thus enable reimbursement, business expenses need to meet four requirements. First, they must be in connection with business activities. Second, they must be adequately substantiated to an employer within a reasonable time period, i.e., not more than 60 days after an expense is incurred. Third, any excess reimbursement must be returned to the employer within a reasonable time period, i.e., not more than 120 days after the reimbursement. Fourth, the employer needs to reimburse an employee out of its own funds, and not through

a deduction of an employee's salary.

Ministers and Finances

It is generally unwise for a minister to be in charge of a church's finances due to the potential for conflicts of interest, lack of oversight, and the legal separation of responsibilities between the spiritual and temporal affairs of a church. Under Section 5 of New York's Religious Corporations Law, the administration of a church's temporal affairs, including its finances, is entrusted to the church's trustees. Specifically, trustees are responsible for the custody and control of the church's property and revenues, which must be administered in accordance with the discipline, rules, and usages of the church, as well as applicable laws.

"The primary purpose of the Religious Corporations Law is to provide for an orderly method for the administration of the property and temporalities dedicated to the use of religious groups and to preserve them from exploitation by those who might divert them from the true beneficiaries of the trust." *St. Nicholas Cathedral of the Russian Orthodox Church in N. Am. V. Kedroff,* 302 N.Y. 1, 29 (1950). By design, the legislature separated the governance of a church's temporal and spiritual affairs. The trustees, as corporate officers, are charged with managing the church's temporal affairs, while the minister and other ecclesiastical officers focus on spiritual matters. This separation will ultimately prevent conflicts and ensure that financial decisions are made transparently and in the best interests of the church. Moreover, annual corporate meetings provide the church's membership final oversight not only by reviewing and approving budgets but also by electing qualified trustees.

These statutory provisions underscore the importance of separating financial responsibilities from spiritual leadership to ensure proper governance and accountability. Case law further highlights the risks associated with a minister controlling church finances. In *People v. Osborne,* 161 A.D.3d 1485, a pastor was found to have misused church funds for personal expenses, including unauthorized payments and cash withdrawals, due to the lack of financial oversight during his tenure.

This resulted in significant financial discrepancies and legal consequences for the pastor, including criminal charges and restitution. The church's failure to implement appropriate financial procedures not only compromised its fiscal integrity and organizational stability but also contributed to its minister's legal difficulties. These unfortunate circumstances would likely have been identified and avoided had there been financial oversight.

Conclusion

The failure to establish and enforce proper mechanisms for financial governance poses significant risks, including potential misuse of funds, lack of accountability, and legal violations. To mitigate these risks, it is essential to adhere to the statutory framework and governance structures established under New York law, which entrust financial responsibilities to trustees and require oversight by the church's membership at corporate meetings. And the trustees should always implement a robust system of financial oversight.

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