

Legal Counsel

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Corporate Governance for Churches & Their Leaders

M SMITH | LAW PLLC



Church Boards Should Consider Liquidity Risks



Most organizations need a certain amount of liquidity on hand to be successful. Liquidity helps institutions have sufficient working capital, emergency reserves, and financial fuel for future opportunities.

We raise this topic as a corporate governance matter for church boards. Leaders are responsible for ensuring the church has the necessary resources to meet all needs. Liquidity is an issue that deserves the board's full attention.

Liquidity is generally defined as cash or other assets that can be quickly converted into cash. Cash includes bank deposits in checking, savings, and other accounts with no restrictions on withdrawals. Liquidity can also be other forms of property that has a ready market for a fast sale.

Church liquidity is important for at least four reasons. The first of which includes compliance with contracts or loan covenants. Churches that have outstanding loans usually must comply with credit stipulations. A common requirement is a demand by the lender that the church maintains a minimum amount of cash on hand.

The second reason for liquidity importance is to meet working needs. Most organizations face operating costs. Expenses include utilities, office overhead, salaries, and building maintenance. Adequate levels of liquidity ensure the church's basic demands are met.

The third reason for liquidity is to meet emergency needs. Occasionally, expenses arise that catch management off guard. Emergencies include local economic shocks that hamper the community. This can be a weather-related disaster or the closure of a large employer. Emergencies also come about due to large, unexpected capital improvements.

The fourth justification for liquidity is to have a war chest for sudden opportunities. Church officials may uncover prospects to enhance the ministry by investing in a certain outcome. Take for instance an opening where the church can expand community outreach by purchasing supplies to meet a pressing need. Having sufficient liquidity on hand may afford church leadership the ability to exploit prospects.

Liquidity can help a church expand its reach. The lack of liquidity may limit leadership's options for the future.

Church boards should understand the dynamics liquidity play in overall financial management. Board members can help the church monitor fiscal performance and strategic planning.

Boards should receive relevant reports to ascertain the church's liquidity levels. Liquidity can be measured in dollars or as a ratio. In either instance, the church leadership should have established metrics, limits, and thresholds to gauge liquidity adequacy.

Liquidity can also be obtained with a line of credit. The board may acquire a source of contingency liquidity through a commercial bank or other lenders.

All lines of credit are not created equal. The interest rate, fees, and conditions often vary. Directors who shop around may be able to obtain more favorable terms.

Finally, church leadership should discuss and determine how much liquidity is needed. The answer will depend on several factors.

- *Future Capital Improvements*: Older equipment such as HVAC, sound systems, and furnishings will eventually need to be replaced.

- *Weather Risks*: The likelihood of damage from adverse weather such as storms is an important risk for which management should be prepared.

- *Ministry Growth*: Leaders who anticipate rapid growth should expect to incur higher operational costs. Extra liquidity prepares for a growing congregation's needs.

- *The Vision*: The aspirational hopes of the church should play a role in liquidity management. A sound financial plan is critical to management's achievements.

The liquidity needs of the church is an important consideration for its leaders. The governing board should take liquidity into account when managing today and planning for the future. ■



Does Your Church Have a Compensation Committee?

The establishment of a Compensation Committee can be a critical governance tool. A Compensation Committee may help ensure fairness, transparency, and accountability when it comes to pay rules. This is especially important as churches occasionally operate under scrutiny regarding their financial practices.

It is crucial for church leaders to demonstrate effective corporate management. A system for making sound compensation decisions help make all other operations work smoother. Moreover, compensation governance helps ensure strict adherence to ethical and legal standards.

A Compensation Committee plays a vital role in guiding the church through complex compensation decisions that align with both legal standards and its corporate culture. This approach ultimately enhances the operational integrity and the public perception of the church.

Here are several reasons why a church needs a Compensation Committee and the roles the Committee typically plays:

1. Objective Decision Making

A Compensation Committee, typically composed of members who are not part of the day-to-day staff, can provide objective assessments of compensation levels. This helps prevent conflicts of interest that might arise when staff or closely involved members determine their own or each other's pay.

2. Compliance with Legal Standards

Churches, like other non-profit entities, must comply with the Internal Revenue Service (IRS) regulations and local

employment laws. A Compensation Committee ensures that pay practices meet legal standards and that the church adheres to guidelines on reasonable compensation for non-profit organizations.

3. Transparency and Accountability

Transparency in how salaries are set and adjusted is critical for maintaining trust among staff, within the congregation and with the public. A Compensation Committee helps ensure that decisions about pay are made openly and are well-documented, which can protect the church against legal claims.

4. Attracting and Retaining Talent

Competitive and fair compensation is essential for attracting and retaining qualified staff. A Compensation Committee can conduct or commission salary surveys and benchmarking studies to ensure that the church's pay scales are competitive with similar roles in the market and among other nonprofits.

5. Alignment With Church Goals

Compensation strategies should align with the church's mission and goals. A Compensation Committee can help link pay structures to the strategic objectives of the church, ensuring that compensation acts as a motivator to further the church's mission.

6. Handling Sensitive Issues

Discussions about money can be sensitive. A Compensation Committee can serve as a neutral body to handle thorny issues regarding pay disparities, raises, and bonuses. The Committee can help avoid potential tensions that might arise if such discussions are handled in less formal settings with nonprofessionals.

7. Regular Review and Updates

Compensation needs may change over time due to economic conditions, changes in church size, and shifts in responsibilities. Regular reviews by a Compensation Committee can help ensure compensation remains relevant and fair.

8. Compensation Committee Roster

The Compensation Committee should consist of a group of trusted and knowledgeable individuals. Ideally, the roster will include individuals with expertise in HR, law, and finance. Members should be independent to avoid conflicts of interest.

9. Committee Engagement

The Committee should meet regularly, such as quarterly or bi-annually, and as needed when issues arise that require attention. Minutes from each meeting should be kept on hand. Complete record keeping is critical for maintaining good practices.

10. Policy Development

A Compensation Committee has several responsibilities. The first of which is to develop and maintain a Compensation Policy. A clear Compensation Policy should include criteria for setting salaries, benefits, and bonuses.

The Compensation Committee should ensure all compensation decisions are documented and compliant with both internal policies and external legal requirements.

In conclusion, creating a church Compensation Committee is a proactive measure that helps foster an environment of trust, efficiency, risk management, equity, and professionalism. ■



The Moment

You realized you did not know
about all the risks you face.

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The Importance of Internal Controls

One of the fiduciary duties of church officials is to manage corporate assets. This stewardship responsibility involves the assurance that all properties are safeguarded.

An important way to ensure church assets are adequately protected is with effective internal controls. Internal controls benefit the church and its officers. The lack of internal controls can be especially harmful to the church and its officers.

Internal controls is the system of checks and balances that prevent errors and/or fraud. All organizations are vulnerable to mistakes that can lead to losses. Church officials are expected to minimize the risks that create systemic failures.

Inherent in all institutions is the chance that fraud can occur. Fraud includes theft of church property through embezzlement, misuse, or conversion. Conversion occurs when an official takes church assets with no intent of returning it. Internal control provides a safeguard against these temptations.

Some risks to the church may come from external parties. Vendors who have unreasonable access to church property could create a hazard. Visitors who are allowed to roam unsupervised in secured areas could render church controls useless.

It can be especially injurious to an innocent person when an issue arises with inadequate internal controls. Take for instance a case of missing money. A guiltless employee could find accusations level against him because he was close to the money. Without internal controls, the accused may have no viable defense to clear his name.

An effective internal controls environment begins with having the correct culture. Church employees and volunteers must accept the importance of safeguarding all aspects of the ministry.

Policies should be established and procedures put in place to guide church operations. The procedures should be practical, reasonable, and consistent. Training should also be provided for all who have a role in each risk area.

Here are some practical tips for church internal control systems.

1. *Practice Dual Control.* No single person should handle cash, checks, or valuable commodities without a witness. Additionally, access to valuable properties should require two or more persons. This rule will avoid putting well-intentioned individuals at risk of a mistake turning into an accusation.

2. *Separation of Duties.* Persons who are responsible for various aspects of

bookkeeping should be separated for their own protections. The person who writes checks should not be the same who approves invoices and reconciles account statements. Different individuals can hold each other accountable and put multiple eyes on each transaction.

3. *Create Internal Audit Process.* Church officials should put a system in place to check everyone's work. Internal audits may uncover weaknesses in the church controls. The auditor should be a person not affiliated with the area under review.

4. *Protect all Data.* Churches often have personal member information. Private consumer data could be exploited by wrongdoers. It is crucial the church safeguards this information from falling into the hands of individuals with bad motive. An internal control process that ensures confidentiality and data protection will lower the risk of a harmful breach.

5. *Personal Access Prohibited.* Church employees and officials should be prevented from manipulating their own personal information in the church system. This includes giving records, personnel files, credit card usage, and payroll records. Drawing these control lines will help insulate employees from suspicious interest conflicts.

Creating a healthy culture for internal controls and backing it up with effective policies will help protect the church and its officers. Begin the conversation with your church leadership today. You may find that an ounce of prevention can avoid a costly cure. ■

Legal Counsel for Churches is a service provided by M Smith Law, PLLC for members of the religious community. This periodical is intended to help churches and their officials become better prepared to address important legal and governance issues. We hope you find *Legal Counsel for Churches* a valuable resource. For each issue, we try to raise relevant issues and offer some practical alternatives. We welcome your comments and input.

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