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CERTIFIED PUBLIC ACCOUNTANTS

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Finance Committee
The Episcopal Diocese of Central Pennsylvania
Harrisburg, Pennsylvania

In planning and performing our audit of the combined financial statements of The Episcopal Diocese of Central Pennsylvania and Incorporated Trustees of the Diocese of Central Pennsylvania (Diocese) as of and for the year ended December 31, 2015, in accordance with auditing standards generally accepted in the United States of America, we considered the Diocese's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Diocese's internal control. Accordingly, we do not express an opinion on the effectiveness of the Diocese's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the Organization's financial statements will not be prevented, or detected and corrected on a timely basis. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the following deficiencies in the Diocese's internal control to be significant deficiencies:

Segregation of duties

Segregation of incompatible duties represents a primary control technique in establishing a strong system of internal accounting controls. Segregation of duties is the assignment of responsibility so that no one individual in the organization has access to assets and their related accounting records. Segregation minimizes the risk of an error or irregularity occurring and going undetected. We realize that the Diocese (including the Episcopal Church Women) is not unlike others your size whereby an adequate segregation of duties is not always practical or cost efficient.

Certain areas within the accounting functions that lacked adequate complete segregation of duties included the recordkeeping of the Episcopal Church Women (ECW), the accounting functions related to the transactions within the investment portfolio, the reconciliation of principal and interest payments by parish for the Heistand loans, reconciliation of convention income between the records maintained by the individual responsible for communications and events, and the accounting records and duties related to the processing of approved staff compensation. For example, we noted two instances in which calculation errors were made in determining staff compensation and the errors were not caught. To mitigate the lack of segregation of duties in these areas, management should institute compensating review procedures, as deemed practical such as secondary review of Heistand loan payments by parish, secondary review of staff compensation, periodic review of the ECW records and performance of a reconciliation of convention income. In addition, the Diocese should weigh the costs versus the benefits of adding additional staff.

Financial reporting

The Diocese financial reporting involves two separate reports. One financial report reflects the transactions processed through the bank accounts and the second financial report reflects the transactions processed by the BNY Mellon Trust Department. Financial reporting is a key monitoring tool in the management of the Diocese. While the organization combines the reporting once a year for the annual audit, there is no similar reporting made during the year. Without maintaining a combined reporting during the year, the Diocese is not viewing a true picture of each funds activity during the year. The Diocese should weigh the costs versus the benefits of expanding financial reporting.



Other matters

We believe part of our responsibility, as your independent certified public accountants, is to bring to your attention our observations and suggestions which we feel are opportunities for strengthening internal controls, improving operating efficiency and to assist you in managing the growth of your organization. The comments and suggestions which follow cover current matters which we believe merit your consideration.

Monitoring of expense account classifications in the accounting records

We noted several instances in which expense account classifications in the accounting records were reported in the incorrect account. Errors in not coding expenses properly can result in budget variances not being properly identified and can impact the governing body's ability to monitor financial performance timely and accurately. We recommend that management monthly review the accounting records for indications of expense account classification errors.

Trust withdrawals

We noted that in two out of eleven instances in which trust withdrawals exceeded \$ 10,000 the documentation to support the approval of by the Canon to the Ordinary or the Chair of Finance could not be located. In addition, documentation to support approvals of other withdrawals was not kept in a common location. Lack of maintaining withdrawal approvals could result in overlooking a required approval in which the funds withdrawal contained errors or irregularities that would not have been identified in a timely manner. With the transition to the Episcopal Church Foundation (ECF), we recommend that you review the policy for such withdrawal approvals and coordinate the monitoring with the processes utilized by ECF.

Reporting of certain taxable benefits

During the year, we observed that the reporting of a certain taxable benefit was overlooked. The item was subsequently corrected. We recommend that new or infrequent benefits be reviewed with your payroll provider to determine applicability of any federal, state or local taxation rules.

Operating grant approvals

We observed that the operating grants are approved by an established committee. The records and approvals for these grants are not maintained at the Diocese office. Once the committee work is complete, we recommend that all official records be maintained at the Diocesan offices.

Nellie Bechtel Trust

The Diocese is to receive net income from the Nellie Bechtel Trust for the support, maintenance and betterment of the Nativity Church of Newport. During 2015, we observed that \$ 110,625 of the \$ 178,461 in net income from the trust was paid directly to Nativity Church of Newport. The Diocese should ensure the trustee is meeting their fiduciary responsibilities related to this trust in regards to disbursing funds. We understand that the Diocese is inquiring with the trustee on various administrative duties related to this trust. We concur with this inquiry.

Episcopal Home - Shippensburg

The Episcopal Home at Shippensburg (Home) is operating under the Diocese tax exemption with the Internal Revenue Service. As an integrated auxiliary of the Diocese, the Diocese should ensure the Home's bylaws share common religious doctrines, principles, disciplines or practices with the Diocese and at least annually the Home should report its financial and general operations to the Diocese. The Diocese should ensure this criterion is being met. As an alternative to operating under the Diocese tax exemption, the Home could file separately with the Internal Revenue Service for its own tax exemption. Under accounting standards, the Home is not included in the Diocese financial accounting records as the Diocese does not have financial control of the Home (i.e. the Diocese does not control the membership of the governing body).

Curate agreements

In the past, the Diocese utilized written contracts for services for these positions. In one instance, we observed a written agreement was not obtained. We recommend that written agreements be used to document services to be provided and the amount to be paid for the services.

Southern York parish

In 2015, the Southern York parish was closed. The records of the parish were obtained for safekeeping in the archives at the Diocese. We were unable to obtain the final bank statement for this parish. We did observe the receipt of funds into the Diocese accounts. All records of the Diocese and related program activities should be maintained by the Diocese.

Proposed accounting standards update

In April 2015, the FASB issued an exposure draft of a proposed Accounting Standards Update (ASU) that will affect all not-for-profit entities and is intended to simplify complexities and provide consistency in financial reporting of not-for-profit entities.

The main provisions of the proposed update would require a not-for-profit to do the following:

- Present on the face of the financial statements amounts for two classes of net assets, *net assets with donor-imposed restrictions* and *net assets without donor-imposed restrictions*, the total amount of net assets, and the related changes in the net asset classes and total net assets. The new classes of net assets replace the current requirement of three classes of net assets.
- Present on the statement of activities two additional subtotals of the operating activities that are associated with changes in net assets without donor restrictions:
 - ✓ Operating revenues, support, expenses, gains, and losses that are without donor-imposed restrictions before internal transfers.
 - ✓ Effects of internal transfers resulting from governing board designations, appropriations, and similar actions that place or remove self-imposed limits on the use of resources that make them available or unavailable for current-period operating activities.
- Present on the face of the statement of cash flows the net amount for operating cash flows using the direct method or reporting.
- Classify certain cash flows differently than they are currently classified:
 - ✓ Classify as operating cash flows (rather than investing cash flows) those cash flows resulting from:
 1. Purchases of long-lived assets
 2. Contributions restricted to acquire long-lived assets
 3. Sales of long-lived assets

- ✓ Classify as financing cash flows (rather than operating cash flows) those cash flows resulting from payments of interest on borrowings, including management activities.
- ✓ Classify as investing cash flows (rather than operating cash flows) those cash flows resulting from receipts of interest and dividends on loans and investments other than those made for programmatic purposes.
- Provide enhanced disclosures about the following:
 - ✓ Governing board designations, appropriations, and similar transfers that result in the addition or removal of self-imposed limits on the use of resources without donor-imposed restrictions. Those disclosures would include a description of the purpose, amounts and types of transfers and qualitative and quantitative information about any period-end balances of board designations of net assets without donor restriction.
 - ✓ Composition of net assets with donor restrictions at the end of the period and how the restrictions affect the use of resources.
 - ✓ Management of liquidity and quantitative information as of the reporting date about financial assets available to meet near-term demands for cash, including demands resulting from near-term financial liabilities.
 - ✓ Expenses, including amounts for operating expenses by both their nature and function. That information could be provided on the face of the statement of activities, as a separate statement, or in the notes to the financial statements.
 - ✓ Methods used to allocate costs among program and support functions.
 - ✓ Underwater endowment funds, which are donor-restricted endowment funds for which the fair value of the fund is less than either the original gift amount or the amount required to be maintained by the donor or law. The not-for-profit would also be required to disclose the aggregate of the original gift amounts (or level required by donor or law) for such funds and any governing board policies or decisions to spend or not spend from such funds. The not-for-profit would classify the amount by which the endowment is underwater in net assets with donor restrictions rather than in the current unrestricted net asset category.
- Use the placed-in-service approach for reporting expirations of restrictions on gifts of cash or other assets to be used to acquire or construct a long-lived asset, eliminating the option to release the donor-imposed restriction over the estimated useful life of the acquired asset.
- Report investment income net of external and direct internal investment expenses.

This communication is intended solely for the information and use of the Council of Trustees, the Finance Committee, management and others within the Organization and is not intended to be, and should not be, used by anyone other than these specified parties.

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