



Lutheran Church Missouri Synod CNH District

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Agenda

- Morning Session
 - Unrelated Business Income (UBI)
- Afternoon Sessions
 - What is an audit?
 - Cash versus accrual basis
 - Cybersecurity
 - Internal Controls
 - Financial Statement Changes



Unrelated Business Income (UBI)

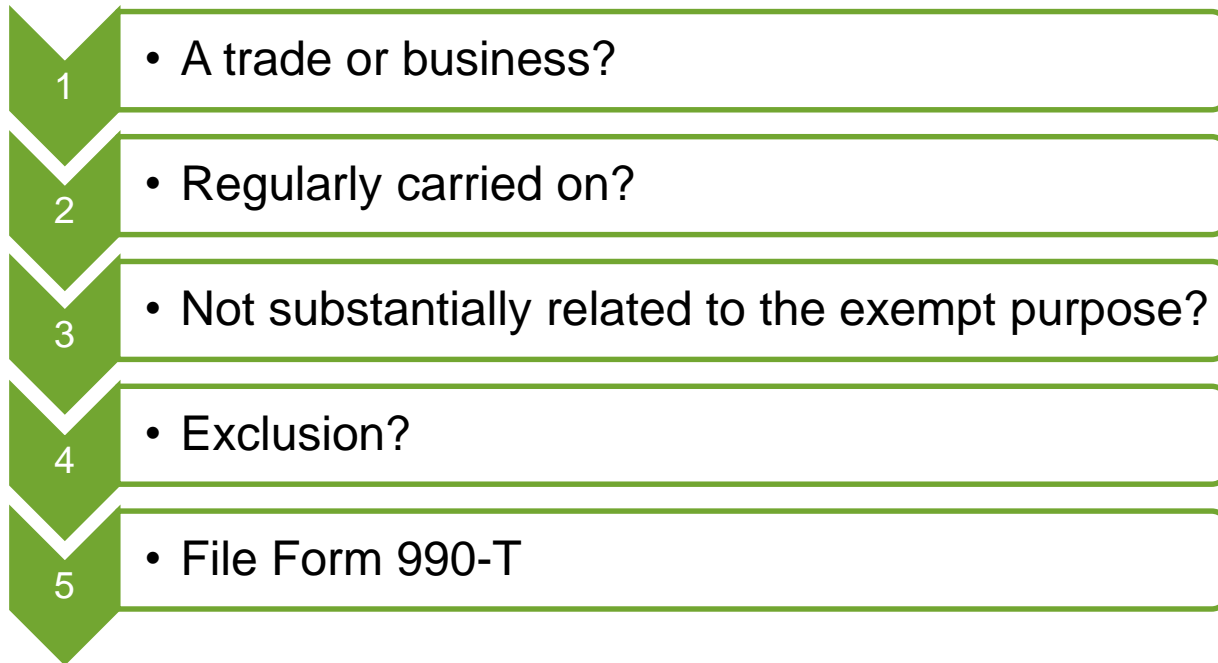
Where Can UBI Hide?

- Property Rentals
- Services
- Websites (banner ads & “click-thru”)
- Goods/Products
- Facilities
- Catering
- Advertising
- Trade Shows (Virtual)
- Cell Phone Towers
- Sports Sponsorships*
- Shops, Bookstores
- Cafeterias, Coffee Shops
- Stadiums, Gyms, Arenas, Chapels, Theatres
- Health/Recreational Facilities
- Golf Courses (Frisbee)
- Storage Facilities
- Parking Lots/Garages
- Farms, Groves, Orchards
- “Boutique Hotel”
- “Commerciality”

Unrelated Business Income

- Foundational Principle:
 - Key is how the money is **earned**, not how it's used
- 3-prong definition:
 - Trade or business
 - Regularly carried on
 - Not substantially related to exempt purpose

UBI Flowchart



Exclusions

- Certain activities are statutorily excluded from the unrelated business income (UBI) rules, although they may meet the definition of an unrelated trade or business
- In addition, case law provides various other exclusions for specific activities

The Most Common Exclusions

- Volunteer labor
- Member's convenience
- Donated merchandise
- Conventions and trade shows
- Games of chance
- Distribution of low-cost items for donations
- Qualified corporate sponsorship income

The Most Common Exclusions (continued)

- Interest, dividends, and similar income
- Royalties
- Real property rental income
- Gains and losses from the disposition of property
- Neighborhood land rule
- Debt-financed – 15% rule
- “Schools” – I.R.C. Section 514(c)(9)

The 5 Usual Suspects

1. Facility rentals
2. Personal property rentals
3. Advertising / Substantial Return Benefits
4. Services
5. Broadcast tower rentals (cell towers)

Real Property Rental Income

- Real property generally excluded
- Exception: debt-financed property
 - Less than 85% used for exempt purpose
 - Income earned on that investment is included in UBIT
 - Proportionate to the ratio of debt on the property to the property's tax basis
 - “Schools” – I.R.C. Section 514(c)(9)

Personal Property (Equipment)

Less than 10% of real property rental = no UBI

If between 10% – 50%, pro rata share of income is UBI

If personal property included in real property is over 50%
= 100%

Corporate Sponsorships

Six acceptable actions

1. Listing the name, logo, or product line of sponsor
 2. Awarding exclusive sponsorship award (e.g., via industry: one to airline, one to hotel industry)
 3. Providing logos or slogans that do not contain any qualitative language or comparative description of the products
 4. Listing of payor's locations, addresses, phone numbers, and Internet addresses
 5. Providing value-neutral descriptions of the sponsor's product display
 6. Listing sponsor's brands or trade names
-

Advertising

There are four items that cannot be done:

1. Advertising
2. Designating a sponsor as an exclusive provider
3. Providing facilities, services, or other privileges to the sponsor unless they are of “insubstantial value”
4. Granting of either exclusive or nonexclusive rights to use Church’s intangible asset (e.g., name or logo)

Cell Tower

Situation 1:

R is a private college that owns and operates a radio station whose activities are related to its exempt purpose. The transmission equipment is on a stand-alone tower on R's campus and there is no debt on the tower property. The tower is not considered real property under the laws of the state in which R is located. R rents space on the tower to a cellular phone company. The rental income from the cellular phone company is unrelated business income.

Cell Tower

Situation 2:

The facts set forth in Situation 1 are the same, except that R's radio tower is located on top of a dormitory. There is no acquisition indebtedness on the dormitory building. The tower is part of a building and is considered real property under the laws of the state in which R is located. The rental income from the cellular company is excluded from unrelated business income.

Cell Tower

Situation 3:

L is a public university that enters into an agreement with a telecommunications company, M, to lease real property to M on which M will build a cell phone tower. L will not provide any services and will not put any of its equipment on the tower. M will erect the tower and place a fence around the tower. M will also pay all expenses associated with the cell phone tower. The rental income to L is not unrelated business income.

Other Considerations

Unrelated Business Income has other considerations:

1. Property tax exemption
2. Loss of tax exempt status (if abused)
3. Filing federal (990T) and state (where applicable) returns
4. Publication 598, Tax on Unrelated Business Income of Exempt Organizations



What is an audit?

Audit Review Compilation

	COMPILATION	REVIEW	AUDIT
Level of Assurance Obtained by the Accountant/Auditor that the Financial Statements Are Not Materially Misstated	Accountant does not obtain or provide any assurance that there are no material modifications that should be made to the financial statements	Accountant obtains limited assurance that there are no material modifications that should be made to the financial statements	The auditor obtains a high, but not absolute, level of assurance about whether the financial statements are free of material misstatement
Overall Objective	To assist management in presenting financial information in the form of financial statements without undertaking to provide any assurance that there are no material modifications that should be made to the financial statements	To obtain limited assurance that there are no material modifications that should be made to the financial statements	To obtain a high level of assurance about whether the financial statements as a whole are free of material misstatement thereby enabling the auditor to express an opinion on whether the financial statements are presented fairly, in all material respects
Assurance Provided to the User of the Financial Statements	None - the report states that no assurance is provided	None - the report provides a statement that the accountant is not aware of any material modifications that should be made to the financial statements	None - the auditor provides an opinion as to whether the financial statements present fairly, in all material respects, the organization's financial position, results of operations, and cash flows
The accountant is required to obtain an understanding of the entity's internal control and assess fraud risk			✓
The accountant is required to perform inquiry and analytical procedures		✓	✓
The accountant is required to perform verification and substantiation procedures			✓
Situations requiring different levels of service	Generally appropriate for smaller, less complex organizations and are often prepared for simple situations (e.g. a lender needs GAAP financial statements instead of the statements the internal accounting system produces or the lender needs the comfort provided by knowing that an accountant read the financial statements)	Often prepared for organizations because of requirements of outside third parties (such as banks, donors, and requirements of membership organizations) that are looking for comfort that there are no material modifications that should be made to the financial statements, or because of board or other organizational requirements	Often prepared for organizations because outside third parties (such as banks, donors, and membership organizations) require an auditor's opinion on the financial statements, or because of board or other organizational requirements
Differences in costs for each level of service	Involves the lowest amount of work and as a result is far less costly than a review or audit	More costly than a compilation but substantially lower in cost than an audit	Involves the most work and therefore the cost is substantially higher than a review or compilation



Cybersecurity

Cybersecurity

Is your data secure?

- Cyber attacks are a significant risk for ALL nonprofits
 - No organization is too small
- It's vital to protect your organization's information systems, data, and public trust
- The threats change quickly and often

Cybersecurity

Trends

- Increases in malware, vulnerabilities, and phishing
- Increased reliance on information technology
- Hacktivism/ransomware is a growing threat

Cybersecurity

Common Cybersecurity Weaknesses

- Believing cybersecurity is an IT issue only
- Passwords (weak, same, and/or never changed)
- End users

Cybersecurity

Best Practices for Churches

- Accept that your church is at risk
- Understand the threats
- Appoint a cybersecurity champion
- Implement – and maintain – network and workstation controls

Cybersecurity, continued

Best Practices for Churches, continued

- Use strong passwords
- Create a culture of security
- Test to identify risks
- Remember cybersecurity is evolving and your church needs to as well



Internal Controls (Segregation of Duties)

Segregation of Duties

Two-Person Segregation	
Bookkeeper	Business Administrator
(Accounting and Authorization)	(Access and Authorization)
PETTY CASH:	PETTY CASH:
Disburse petty cash	Reconcile petty cash
RECEIPTS:	RECEIPTS:
Open mail/Count offering*/Make listing	Prepare deposit slips
Post accounts	
Post G/L	
DISBURSEMENTS:	DISBURSEMENTS:
Post G/L	Complete check register
Write checks	Prepare invoices
Post C/D journal	Sign checks**
Authorize purchase orders	Approve expense reports
Approve invoices for payment	Approve credit card statements
Authorize check requests	
Mail checks	

Segregation of Duties, continued

Two-Person Segregation	
PAYROLL:	PAYROLL:
Post G/L	Sign employee contracts
Write checks	Sign checks**
Post C/D journal	Approve time sheets
Approve payroll	Distribute payroll
RECONCILIATION:	RECONCILIATION:
Reconcile bank statements	Reconcile petty cash
	Review and approve bank reconciliations
OTHER:	OTHER:
Authorize credits and discounts	Record pledges
	Review G/L and F/S monthly
	Perform interfund transfers
	Custody of cash and investments
* Dual counting, with a volunteer or other employee	
**Dual signature, which includes a member of the Board	

Segregation of Duties, continued

Three-Person Segregation		
Bookkeeper (Accounting and Authorization)	Business Administrator (Access and Authorization)	Treasurer (Access)
PETTY CASH:	PETTY CASH:	PETTY CASH:
Reconcile petty cash	Disburse petty cash	
RECEIPTS:	RECEIPTS:	RECEIPTS:
Post accounts	Open mail/Count offering*/Make listing	Prepare deposit slips
Post G/L		
DISBURSEMENTS:	DISBURSEMENTS:	DISBURSEMENTS:
Post G/L	Authorize purchase orders	Sign checks**
Write checks	Prepare invoices	Approve BA's expense reports
Post C/D journal	Approve invoices for payment	Approve BA's credit card statements
Complete check registers	Mail checks	
Authorize check requests	Approve expense reports	
	Approve credit card statements	

Segregation of Duties, continued

Three-Person Segregation		
PAYROLL:	PAYROLL:	PAYROLL:
Post C/D journal	Approve payroll	Sign employee contracts
Write checks	Distribute payroll	Approve time sheets
Post C/D journal		
RECONCILIATIONS:	RECONCILIATIONS:	RECONCILIATIONS:
Reconcile bank statements	Review and approve bank reconciliations	
OTHER:	OTHER:	OTHER:
Authorize credits and discounts	Record pledges	Perform interfund transfers
	Review G/L and F/S monthly	Custody of cash and investments
*Dual Counting, with a volunteer or other employee		
**Dual signature, which includes a member of the Board		

Segregation of Duties, continued

Four-Person Segregation			
Bookkeeper (Accounting)	Clerk (Access)	Business Administrator (Access and Authorization)	Treasurer (Access)
PETTY CASH:	PETTY CASH:	PETTY CASH:	PETTY CASH:
Reconcile petty cash	Disburse petty cash		
RECEIPTS:	RECEIPTS:	RECEIPTS:	RECEIPTS:
Post accounts	Open mail/Count offering*/Make listing	Prepare deposit slips	
Post G/L			
DISBURSEMENTS:	DISBURSEMENTS:	DISBURSEMENTS:	DISBURSEMENTS:
Post G/L	Complete check registers	Authorize purchase orders	Sign checks**
Write checks	Mail checks	Prepare invoices	Approve BA's expense reports
Post C/D journal		Approve invoices for payment	Approve BA's credit card statements
		Authorize check requests	
		Approve expense reports	
		Approve credit card statements	

Segregation of Duties, continued

Four-Person Segregation			
PAYROLL:	PAYROLL:	PAYROLL:	PAYROLL:
Post G/L	Distribute payroll	Approve payroll	Sign checks**
Write checks			Sign employee contracts
Post C/D journal			Approve time sheets
RECONCILIATIONS:	RECONCILIATIONS:	RECONCILIATIONS:	RECONCILIATIONS:
Reconcile bank statements		Review & approve bank reconciliations	
Reconcile petty cash			
OTHER:	OTHER:	OTHER:	OTHER:
	Record pledges	Authorize credits and discounts	Perform interfund transfers
		Review G/L and F/S monthly	Custody of cash and investments
			Review G/L and F/S monthly
*Dual counting, with a volunteer or other employee			
**Dual signature, which includes and member of the Board of Directors			



Financial Statements of Not-for-Profit Entities (ASU 2016–14)

Financial Statements of Not-for-Profit Entities

Key Objectives

- Update, not overhaul, the current model
- Improve net asset classification scheme
- Improve information in financial statements and notes about:
 - Financial performance
 - Cash flows
 - Liquidity
- Better enable NFPs to “tell their financial story”

Phase I

Aim: Final ASU by mid-2016, effective for calendar year 2018
(fiscal year 2018-19)

Net Asset Classes:

- Classification scheme
- Disclosure of board designated net assets
- Underwater endowments
- Expirations of capital restrictions

Expenses/Investment Return:

- Expenses by nature; analysis of expenses by function and nature
- Netting of investment expenses against investment return
- Disclosure of netted investment expenses
- Enhanced disclosures about cost allocations

Operating Measures:

- Modest improvements to disclosures for those that use an operating measure, especially about board appropriations, designations, and similar transfers

Liquidity/Availability:

- Quantitative disclosures about availability
- Qualitative disclosures about liquidity
- Consideration of alternatives suggested by stakeholders (e.g., classified balance sheet)

Statement of Cash Flows:

- Methods of presenting operating cash flows (direct/indirect)

Phase II

Operating Measures – all other elements of the proposal, including:

- Whether to require intermediate measure(s)
- Whether and how to define such measure(s), and what items should or should not be included in the measure(s)
- Alternative disaggregation approaches suggested by stakeholders

Statement of Cash Flows:

- Realignment of certain items

Effective Date, Early Adoption, and Transition

- **Effective Date:** For fiscal years beginning after December 15, 2017 (calendar year 2018 and fiscal year 2019)
 - Interim financials the following year
- **Early Adoption:** Permitted, but must apply the regular transition provisions
- **Transition:**
 - For year of adoption: apply all provisions
 - For comparative years presented: apply all provisions, except can choose not to present:
 - 1) Analysis of expenses by nature and function,* and/or
 - 2) Disclosures around liquidity and availability of resources

**unless already required to do so under current GAAP*

Final Words

- Beginning sooner rather than later will make final implementation so much easier
- Work with the board and auditors to develop the format
- Tell your story

Accounting for Financial Instruments – Measuring Credit Losses – Topic 326

- **At core of ASU 2016-13 is new Current Expected Credit Loss (CECL) model**
 - Focuses on what a reporting entity expects to collect, rather than on whether the loan/other asset has “gone bad” (incurred loss model)
 - *Considers past history, current conditions, reasonable expectations about foreseeable future*
- **CECL model not expected to result in significant impact on most entities other than financial institutions (foundations)**
 - For NFPs, would apply to trade receivables, loans receivable, and lease receivables, but not to pledges receivable
 - *Likely already taking CECL considerations into account for such assets*

Questions?



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Thank you.

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