

January 26, 2021

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St. Luke's Lutheran Church, Inc.
Middleton, Wisconsin

We are pleased to provide this letter containing our comments and recommendations regarding our observations of St. Luke's Lutheran Church, Inc.'s internal controls and operations. This letter is based on discussions with the business manager and financial accountant, Marlo Lewis, and is based on the scope of services as outlined in our engagement letter dated December 1, 2020.

Scope of the Engagement

The accounting records for church operations were reviewed for the twelve-month period ending December 31, 2020. Review procedures were performed as described in the engagement letter and as applicable to the circumstances. Although this review included an examination of the accounting records and documentation for a sample of transactions, it was not intended to be comprehensive in scope. Therefore, although no irregular transactions were found, this review cannot and should not be relied upon to determine that all funds and transactions of the church were accurately reported.

Introduction to Internal Controls

The general objectives of any sound internal control system include preventing and detecting loss or theft of assets; minimizing opportunities for employees or others to steal, misuse, or accidentally destroy assets or records; and providing information to accurately report on the organization's activities, which includes capturing and correctly identifying all transactions, properly recording them, and not recording transactions that did not occur. There are two primary types of controls: preventative and detective. Preventative controls help prevent fraud or errors from occurring, while detective controls assist in the prompt detection of fraud or errors once they have occurred. In smaller churches, there will be a heavier reliance on detective controls rather than preventative controls as the cost of a preventative control is higher in a smaller church. In all situations, there should be sufficient controls to reduce the risk of intentional or unintentional errors to a minimum. A detective control will mitigate the risk when a preventative control is not present.

Importance of Internal Controls to Reduce Fraud and Abuse

Prior to outlining our observations and recommendations, we would like to help you understand how fraud happens.

In the "fraud triangle," three elements must exist for a fraud to occur:

- 1) Opportunity
- 2) Pressure or incentive (e.g. husband lost job and we cannot afford the mortgage)
- 3) Rationalization (e.g. I deserve a little something for all the hours I have volunteered)

Based upon the fraud triangle, even those of us that have lived good, honest lives can suddenly be faced with a situation that fulfills all three elements of the triangle. Because the church cannot eliminate the pressure/incentive or rationalization components, it must ensure policies and procedures are in place to limit as much opportunity as possible. It is not simply a matter of trust, but a matter of protecting people put in the position of trust from being subject to unreasonable temptation.

Detailed Observations and Expectations

I. Council

We reviewed the Council's meeting minutes for the year ended December 31, 2020. The Treasurer routinely reports on year-to-date results compared to budget in order to identify areas potentially needing further analysis or Council action. During 2020, we noted the adoption of a conflict of interest policy. We recommend this be updated annually and noted in the minutes. We also recommend the conflict of interest policy be utilized by the Foundation Committee and updated annually. The minutes also reflected updates to the personnel handbook and job descriptions, new staff positions and new hires, the financial and operational impacts of the pandemic, approval of pastor housing allowances, and refinancing of the mortgage. There were no other significant issues noted in the 2020 minutes.

In January 2021 the Council approved creating an operating reserve. This is an important part of building financial strength and resiliency. We recommend building on this foundation by defining a few key performance indicators and determining what are the operating levels for that key indicator. The levels or ranges could be green, indicating all is going well; yellow indicating there is modest deviation requiring attention; and red indicating a significant deviation requiring immediate action. Defining the key indicators and determining these levels in advance is an effective method to communicate expectations and risk aversion, as well as providing an easy monitoring mechanism.

II. Budget

We reviewed the church's 2020 annual budget and budget versus actual results. The budget, including using the general fund for mortgage payments, reflected a deficit before adjustments for prepaid contributions and savings. No dispositions of assets or restructuring of debt were included in the budget.

When analyzing budget versus actual results, we noted the following items that we deemed significant:

- General and holiday giving was approximately 94% of the budget. The primary impact to the reduced giving was the limitation of in-person services due to the pandemic.
- Pastor salaries and benefits were lower than budgeted, as a new pastor was not hired until the last quarter of 2020.
- Staff salaries and benefits were also lower than budget for staff reductions and timing of new hires due to the pandemic.
- Utilities were 78% of budget due to the reduced building usage during the pandemic.
- Youth ministry was 44% of budget as many events and programs were cancelled due to the pandemic.
- Evangelism expenditures were 45% of what was budgeted. The most significant reduction was for the fall programming and holiday promotions.

These all appear reasonable based on our procedures and inquiries.

III. Financial Reporting

We reviewed the entries to the net asset accounts. We noted the primary activity was transfers between restricted or designated net asset funds. We also reviewed the monthly journal entry reports noting review by the treasurer. We did not note any unusual activity.

IV. Offering

We reviewed current offerings compared to historical offering data and noted regular offerings were lower than the previous year. Holiday and special offerings were also lower compared to the previous year. As noted in the budget section, this is likely due to the pandemic. Given the offerings were also lower in 2019 compared to 2018 we recommend developing strategic financial alternatives in order to respond to future trends in a timely manner.

We selected a sample of tally sheets and agreed the cash and check breakdown per the tally sheet to the bank deposit slips and to subsequent receipt by the bank with no significant findings. We also selected a sample of online giving and agreed the report per Secure Give to the bank deposit and donor giving statements.

The normal offertory count procedures had to be modified during the period of virtual services. The primary difference was the counters used. The business manager and church staff were involved in the count and delivery of the deposit to the bank. The other modification was an increase in online giving through Secure Give. Online giving is approximately 39% of total giving. We recommend encouraging this option to church members to continue increasing the portion of giving done online.

Last year we recommend including the procedures for tracking the tamper proof bags and retrieval of the offering from the safe be added to the documented procedures. The weekly reconciliation to ensure all bags are collected has not been implemented. We also recommended adding several updates to the counting procedures that have not yet been implemented. We also recommended a confidentiality policy be created and signed annually by all counters.

One of the most effective detective controls over the completeness of the offertory collection is the parishioner contribution statement. We reviewed a sample of giving statements, noting donors are instructed to contact the business manager with any questions. The current business manager is involved in the receipt and record keeping process thus we recommend listing the pastor has the contact person. The pastor will likely need the assistance of the business manager to answer any questions but will be aware of any potential discrepancies and the frequency of them occurring.

V. Bank Accounts

The financial accountant appears to have all bank accounts recorded in the general ledger. We agreed all bank balances to the bank reconciliations, as well as general ledger balances per the reconciliations to the general ledger. Additionally, we noted documentation of an independent review of the monthly reconciliation. We recommend that a sample of check images also be reviewed for proper payee, reasonable amount, authorized signatures, and reasonable endorsement, and this review be documented on the bank statement review form. In our review, we noted this step is included on the review form but is not consistently completed.

VI. Liabilities

We agreed the mortgage loan liability total for 2020 per the general ledger to the balance per the end-of-year Thrivent statement. As of the date of our review, the year-end entry to allocate the principal portion of the monthly payments had not yet been recorded. The principal portion and liability balance appear reasonable.

In 2020 the church applied for and received a Paycheck Protection Program loan. Funds have been spent on expenses eligible for forgiveness, but the forgiveness application has not yet been submitted to the bank. We recommend the church apply for the second round of funding and explore possible eligibility for employee retention credits.

VII. Income and Expenses

We scanned the general ledger and all monthly journal entries for unusual activity. No matters came to our attention warranting additional investigation.

We selected a sample of non-offering cash receipts and agreed supporting documentation to the general ledger. Our review of cash receipts did not result in any matters warranting further attention.

We reviewed a sample of cash disbursements for appropriate supporting documentation, review and approval before payment, appropriate business purpose, and account coding. Supporting documentation was readily available and coded correctly. Disbursement approval was noted for building projects, but not all expenditures. We noted no checks made out to "cash."

VIII. Credit Cards

The church has two credit cards and no debit cards. Authorized users for the cards include the pastor, business manager, director of youth ministry, director of senior ministry, music director, Wednesday night cook, and property manager. We recommend review of all based on the frequency and amount of regularly made purchases to determine if an assigned card is still needed and if the card credit limit is appropriate.

We reviewed the credit card statements for all cards for March and August 2020. Credit card statements are reconciled monthly with most reconciliations including all attached receipts. Charges appeared relevant and reasonable. The credit card balance for each of the accounts is paid off each month to avoid interest charges. We reviewed the total credit limit for each card and did not note any unreasonable levels.

IX. Payroll

Payroll Date Services, Inc. is used to process the church's payroll. Per our inquiries, the treasurer reviews and approves the time for the business manager. Additionally, we noted the treasurer has documented review of the payroll register.

No employees have unusual deferred compensation agreements, bonuses, or employee contracts. We noted the pastor housing allowances were approved by the Council at the March meetings. The approval of the housing allowance needs to be in advance of the period in which it applies. Generally, the allowance is for the calendar year, thus we recommend this be approved in December for the upcoming year.

Per our inquiries regarding personnel files, we determined that I-9s are kept for employees separately in the business manager's office. The business manager is in the process of reviewing all employee's I-9 files and obtaining any missing documentation.

We obtained the Form 941's and compared to the general ledger noting proper treatment of pastoral housing allowance.

We noted the personnel manual had been updated and includes a required employee acknowledgement of policies. We also noted job descriptions and classification of positions as exempt or nonexempt have been reviewed and updated as needed.

All non-corporate entities receiving payment of \$600 or more for services rendered are issued 1099's as required. We recommend documenting the services performed for each 1099 along with an explanation of why independent contractor versus employee status is appropriate.

Per our inquiries, there has been no correspondence received from the IRS or State of Wisconsin.

We recommend documenting the policy for conducting background checks. The policy should specify who is subject (both employee and volunteers) to the background check and how frequently it is updated. The policy should also specify the retention period.

X. Foundation

We reviewed the meeting minutes for the Foundation for the year ended December 31, 2020. Meetings were held more frequently than quarterly, and the minutes included appropriate documentation of fund distributions, asset balances, approvals for scholarships, and operating releases to the general fund.

We agreed the Foundation's investment account balance to the Baird investment statement. We noted no significant findings.

We also reviewed the investment and distribution policies required by the by-laws. We noted no violations of these policies. An updated investment policy was in draft as of January 2021.

We noted some confusion with classification of one of the potential endowment funds. We recommend clearly documenting the source of funds, restrictions from the donor, and reasoning as to classification as of funding as unrestricted, restricted, or permanent endowment.

We reviewed the investment statements for documentation of investment expenses, receipts, distributions, and gains/losses. No unusual items were noted. We also noted the investment expenses and asset balance are properly reflected in the church financial statements.

We noted the Foundation has continued working diligently to explore education and communication methods that will encourage advanced estate planning that aligns with the church's needs and policies. We also noted implementation of the recommendation to adopt minimum funding required for establishment of an endowment fund. We noted the website includes multiple mentions of establishing an endowment. To avoid confusion and receipt of gifts not meeting the foundation criteria, we recommend the website include a contact person to discuss details and alignment with the foundation objectives when offering an endowment option for donors.

XI. Related Party Transactions

Related party transactions are financial transactions between two parties who are joined by a special relationship prior to the deal. For example, if the church purchased audio equipment from a company where the treasurer owned, it would be a related party transaction. Although there is nothing inherently wrong with related party transactions, it is particularly important to take certain precautions, as these transactions are susceptible to abuse because they have the potential to financially benefit the related party. We noted the Council adopted a conflict of interest policy as recommended.

We did not note any significant related party transactions occurring during the year per inquiry with the business manager.

XII. Contracts

The church has many strong working relationships with vendors that are reviewed annually. There are no new or significant contracts to note.

XIII. 403(b) Plan

Per our inquiries, two options are available for employee participation. Terms of participation in the plans are included in the employee handbook. Per inquiries, the church complies with plan requirements.

XIV. Capital Assets

During 2020, capital asset included roof and stairs repairs. The capitalization policy for the church remains at \$3,000.

XV. Other Inquiries

We reviewed the accounting procedures manual noting all significant areas are addressed.

The purchase approval process policy is reviewed periodically and regularly communicated with the staff. All major projects/purchases/contracts are discussed with the Council and approved through the budget.

Per our inquiry, insurance coverage is reviewed annually with Church Mutual.

Overall, we noted that the church continues to implement best practices for financial stewardship and related reporting.

XVI. Progress Since Last Engagement

Per our inquiries, the church has addressed the following suggestions made in the report dated January 28, 2020 (for year ending December 31, 2019):

- Conflict of Interest policy adopted

During our inquiries with the business manager we noted the church plans to work on creating functional reporting in the next year. This will provide additional insight into the church's financial story and enhance decision making and planning.

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These comments and recommendations are based upon the scope of our engagement letter and are intended to help St. Luke's Lutheran Church strengthen its internal control systems. We are available to help clarify and implement them at your request.

It has been our privilege to visit your church, and we hope that this report will produce positive results for you and your entire congregation. Please call us at (608) 274-4020 if we can be of help to you in the future.



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