

Thinking Financially in 2010

Leading in lean times requires a new approach.
Matt Branaugh | 2/15/2010

At first glance, the two churches don't have much in common.

One, a large congregation, has enjoyed a front-row seat to history, serving for more than 150 years in the country's epicenter of power, Washington, D.C. The other, a smaller congregation just 80 minutes northwest of the nation's capital, has been serving its Virginia town of less than 2,000 people since the early 1970s.

Big differences, right? Unfortunately, that changed in late December.

That's when the former finance director of the Washington, D.C., church was arrested and charged with stealing more than \$500,000 from that congregation during a six-year span. Less than a week later, the former bookkeeper of the Virginia church was arrested for allegedly stealing about \$300,000 from it over five years.

Both suspects used the money for big-ticket purchases—real estate, cars, jewelry, and furniture—according to the charges filed.

The separate cases underscore a new reality for the new year: the growing risk of embezzlement, regardless of the church's size or setting. "One thing we are seeing on the uptick is embezzlement," says Frank Sommerville, an attorney in Texas specializing in nonprofits and churches. "When you have higher unemployment, you need to be thinking about security from embezzlement."

Your Church magazine asked its Editorial Advisors and Contributing Editors how pastors, business administrators, and executive pastors can lead well amid the changing realities in 2010—and here's what they said.

Guard against the growing risk of embezzlement

One major church insurer logged 32 embezzlement-related claims in 2009, up 12.5 percent from its recent annual averages. "Regrettably, financial misconduct tends to be more predominant in economic downturns," says David Middlebrook, another Texas-based attorney specializing in church law.

Fraud experts often refer to a three-legged stool for embezzlement risk: opportunity, need, and organizational ethos. Opportunity often is born out of non-existent or poorly managed financial controls. A variety of new resources help churches set proper controls, including *The Essential Guide to Church Finances* (2009, Christianity Today International—the parent ministry of *Your Church*), and *Weeds in the Garden* (2009, NACBA Press), as well as guidance from organizations like the Evangelical Council for Financial Accountability (<http://www.ecfa.org/PDF/BestPractices-Churches.pdf>).

In terms of need, church leaders must pay attention to hardships in the lives of their employees. The most common scenario for church fraud involves longtime employees who face an unexpected financial stress—a job loss for a spouse or an extended illness with hefty medical bills for a family member. Some studies suggest the average tenure of a church employee who commits fraud is seven years, Sommerville says, and recent headlines reflect that. "These employees don't start off thinking they're going to steal," he says. "They think they're going to borrow from you and pay you back when things improve."

A strong organizational ethos that encourages transparency and requires high standards also helps prevent financial misconduct. "It really is helpful if churches create this above-reproach, ethical standard, something they continually talk about and include in their code of ethics—'We're going to operate above reproach in every area of ministry from the senior pastor and board on down,'" Sommerville says. "If that's the atmosphere, fellow employees may catch and report them."

Re-think investment strategies

For decades, Wall Street touted the stock market's ability to deliver annual average returns of 10 percent for those who invested the majority of their assets in equities. Even in years when the stock market ebbed rather than flowed, the thinking went, most losses would be regained—and then some—in future years. Tempted, many churches participated, abandoning more conservative approaches that delivered modest earnings but protected principal, says Mike Batts, founder and managing shareholder of a Florida-based CPA firm serving nonprofits.

But the stock market's topsy-turvy past three years has made it "obvious you can lose substantial principal," Batts says. That's a problem, especially when investment earnings fund specific ministry initiatives. During the past 18 months, endowments on average have lost 30 percent of their value, Batts says, shrinking revenue for ministries and creating relational and publicity challenges for churches with donors.

Batts says church leaders should consider returning to less risky investment strategies, such as certificates of deposit and treasury securities held to maturity. While these investments may average only two percent or three percent returns in the current market, the principal remains protected. Before doing so, though, Batts says church leaders need to realize that in some investments, values aren't fully realized until a maturity date, meaning an early cash-out to address a cash crunch can result in lower-than-expected returns. "You must plan your liquidity so that you don't need that money," he says.

Middlebrook says another common pitfall for churches is investment schemes. Richard Hammar, *Your Church's* senior editorial advisor and the senior editor of *Church Law & Tax Report* and *Church Finance Today*, recommends the following steps to avoid financial scams:

- Use an investment committee to make recommendations regarding the investment of funds;
- Create an investment policy that prohibits investments in specified instruments or programs;
- Avoid speculative or risky investments. If a proposal sounds too good to be true, it probably is;

- Avoid investing in companies or programs in which a board member has a personal interest. Such investments are not always inappropriate. But they demand a higher degree of scrutiny.

Call for help early

At Seabreeze Church in Huntington Beach, California, leaders could see problems on the horizon. Balloon payments were on the way for a multimillion-dollar loan the church took out to buy nearly five acres of land and construct a new campus. And between the slowing economy, and the departure of a popular leader, giving was down.

Rather than ride out the situation to see if things might improve, leaders reworked the budget, making cuts based on the new giving realities. They then contacted the Evangelical Christian Credit Union long before there was a threat of missing a payment. The result: ECCU changed the church's payment structure from a principal-plus-interest loan to an interest-only one, and it gave a two-year extension on the balloon.

"(ECCU) liked seeing our budget changes. And they liked seeing that we came to them many months ahead of when the problem was going to hit," says Nick Nicholaou, who has provided technology and management consulting to churches since 1985, and serves on Seabreeze's governing board. ECCU's changes gave Seabreeze more time, and combined with the budget cuts, a balanced budget. "The key is, don't wait until it's too late. If it looks like there might be problems, manage them proactively," he says.

Seabreeze took the same approach with the Huntington Beach Planning Department. To gain approval for its initial construction, the church agreed to build four phases in 15 years. Leaders knew the next three phases weren't likely to happen on that schedule, given the economy, and so they contacted the department to explain their situation. They received a 10-year extension. "They just appreciated we came in ahead," Nicholaou says.

Review budgets early and often

In the past, leaders often waited until the next year to do a new budget, rather than revise an existing one, says Jim Guinn, a CPA in Texas who works with churches. Not anymore. Budget revisions are now frequent, even monthly, occurrences.

At Willow Creek Community Church in suburban Chicago, the church uses a green-yellow-red approach to budgeting, with green-colored budget items approved for purchase, yellow-colored ones in need of an approval, and red-colored items on hold, says Brian McAuliffe, the church's director of operations.

"No longer a once-a-year drudgery, now it is a question of how many versions of the budget do we need—high, low, and middle-of-the-road?" says Dan Busby, president of the Evangelical Council for Financial Accountability. Midflight changes based on significant changes in revenue and expenses are increasingly common, Busby adds.

Busby says church leaders now must embrace budgeting tools that allow constant monitoring and, if necessary, enable revisions. One of those tools, according to Guinn, is a zero-based budgeting approach (*The Essential Guide to Church Finances* calls this "program budgeting"), rather than incremental budgeting. Incremental budgeting takes the previous year's amount and tacks on a percentage increase to account for growth and inflation. With

zero-based budgeting, each department starts at zero and calculates "what it will take to run this, rather than an arbitrary increase," Guinn says.

Build reserves

Churches that have fared better in the past year or two "established rainy day funds and now can dip in," says Lee Dean, who covers religion for a local paper in Western Michigan. For those now struggling, they need to capture any savings—little as they may be—to begin building reserves, Dean says.

"I advocate for churches to have adequate reserves," Sommerville adds. "Those financial reserves are really one of the foundations of operating a church prudently. You never know when a disaster is going to strike or you're going to have downturns in the offerings." At a minimum, a church should try to establish three months' worth of fixed and variable costs, Sommerville says.

Surplus funds, from an unexpected lift in giving or from better-than-expected savings, should be used to reduce debt—or be set aside in case a future renewal of that debt with a lender may not come with as favorable of terms, Batts says. Beyond that, any surpluses should go toward building reasonable reserves for future repairs or purchases, he says.

Give people a variety of meaningful ways to give

After a 7.0 earthquake hit Haiti in mid-January, the American Red Cross successfully raised \$35 million within 48 hours. Half of that came through online contributions and \$5 million arrived via cell phone text messages.

Two lessons can be drawn from this: One, churches must continue to understand the ways electronic tools are changing the ways that people give ("E-give and Take," *Your Church*, September/October 2009). And two, churches must continue to find ways to show people how their giving matters—that their giving is a matter of discipleship and not simply a matter of helping the church meet budget.

Too many churches "limit their giving to a check or cash at 10:25 a.m. on a Sunday, if they happen to be in church. And yet in most churches, one-third of your people are not in the service on a given Sunday," Kluth says. "And if you ask most 28-year-olds to write a check to the Lord's work, they don't even own checks. And they don't carry around that much cash. It's not that they are unwilling to be generous. It's just that we've put up so many limitations to how and when they can be generous."

Churches also must provide compelling connections between the giving and the cause. For instance, at Trinity Episcopal, a global missions emphasis is tied with a special giving opportunity, Throop says. At Christmas, the church also set up a program in which congregants could send letters to family and friends, asking them to give money to a Trinity Episcopal ministry of the donor's choice on behalf of the sender, rather than buy the sender a gift. "People find ways to give extra; especially when they're inspired, they'll dig deeper. But if you tell them they have to dig deeper, they won't do it," Throop says.

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