FREEDOM PLAINS UNITED PREBYTERIAN CHURCH

2021 ANNUAL MEETING OF THE CONGREGTION AND CORPORATION

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The financial reports are, unfortunately, not as simple as we would like them to be. But a lot has been going on at FPUPC over the past few years and we're trying to provide a complete financial picture of this activity to the congregation. We hope that you find the following information helpful in understanding the pages and pages of numbers in the accompanying financial reports!

GENERAL BACKGROUND

It is generally known that the accounting procedures that must be used by a non-profit entity are considerably more complex than the accounting procedures used by a for-profit entity (somebody should have told me this before I offered to do this job). In a for-profit, all of the money "goes into one big pot" and it's entirely management's decision as to how this money gets spent.

On the contrary, non-profits (like FPUPC) receive most of their income in the form of donations, and most of these donations are intended to be used for a specific purpose. The accounting procedures used by a non-profit must account for these donations in a manner that ensures that they will only be used for their intended purpose. While a for-profit effectively has only has to maintain one ledger for its entire business, a non-profit has to maintain multiple independent ledgers to account for donations that are intended to be used for different purposes.

Fund accounting principles (or the equivalent) are used by non-profits to help ensure that all donations they receive are only used only for their intended purposes. The basic building block of fund accounting is a "fund", which is effectively an independent ledger that that accounts for donations intended to be used for some specific purpose. FPUPC currently has about 60 separate funds to account for funds that have been donated to the Church for different purposes.

With the exceptions of the General Operating Fund and the Nursery School Operating Fund, fund accounts are "persistent" or "permanent" accounts. Income to a permanent fund account remains in that fund account until it is spent for its intended purpose, however long that may take. If a permanent fund account has unspent funds in it at the end of a fiscal year, these funds simply "roll over" to the next fiscal year.

FPUPC's funds come in two flavors: operating, and invested.

Operating funds are those which support the ongoing day-to-day programs of the church and the nursery school. The assets of the operating funds are maintained in one or more bank accounts. The Consolidated Fund Activity report provides a summary of the 2020 starting and ending balances and the 2020 cash flow for each of these funds.

Invested funds are those which support the long-term viability of the church. They consist primarily of bequests from former members of the church who are now at peace with their Lord. The assets of the invested funds are maintained in a combination of a legacy bond account, a managed investment account that includes both bonds and equities, and a promissory note on the associate pastor's residence. The Invested Funds report provides a summary of 2020 invested fund activity and balances.

The General Operating Fund supports the day-to-day operations of the Church and is managed by a more stringent set of rules. At the end of each year, the Session approves a detailed budget for the General Operating Fund; this budget includes planned expenses and anticipated income for the coming year. Actual expenditures are then managed based on the approved budget and actual income as it is received during the year.

The 2020 Results and 2021 Budget report provides both the year-end actual vs. budget status of the General Operating Fund for 2019 and 2020, and the approved operating budget for 2021.

The income portion of the General Operating Fund consists of two pieces. "External Operating Income" is current income from unrestricted donations and income derived from use of the Church's facilities. Another way to think of external operating income is that it's the money the Church receives and deposits in its bank account each week.

Like most other non-profit organizations, external operating income does not fully fund all current operating expenses, and it is necessary to draw upon other previously donated income and income earned by the church's investments to fully fund yearly operating budgets. This previously donated and investment income used fund the operating budget is classified as "Internal Asset Transfers". Total operating budget income includes both external operating income and internal asset transfers.

The expense portion of the General Operating Fund budget consists of about 40 individual line items. Since the overall budget has a one-fiscal-year lifetime, so do the individual expense line items in the budget. Amounts budgeted that are not spent during the year "disappear" at the end of the year; the authorization to spend these budgeted funds does not roll over to the following year.

Unlike other fund accounts, the General Operating fund must end each fiscal year with a zero balance. If we spend more from the operating fund than we receive during a fiscal year, the difference must be transferred from other funds to cover any shortfall in the operating fund at the end of the fiscal year.

The following information provides an overview of the fund activity, budget, and invested funds reports along with some explanations that may help answer questions that we anticipate might come to your mind as you review these reports.

2020 FUND ACTIVITY REPORT

The fund activity report lists each fund currently maintained by FPUPC, the balance of the fund at the beginning of the year, how much new money was received by the fund, how much was disbursed from the fund, how much was transferred into or out of the fund (from or to other funds), and the year-end balance of the fund.

The remainder of this section goes into the details of why the funds are organized the way they are in the report, and the unique characteristics of funds that are used to manage internal operations and to ensure that standard accounting reports do not overstate actual church income and expenses. If this type of accounting nitty-gritty doesn't interest you, feel free to fast-forward to 2020 Operating Budget Year-End Results topic in this document. I won't be hurt if you do!

The ungrouped funds that appear at the beginning of this report are used to account for the finances of individual church programs or groups that receive donations or payments. These funds are managed in accordance with the funds disbursement policy that was proposed by the finance committee and adopted by the Session in 2018. Disbursements from any of these funds must be consistent with the intended purpose of the fund and must be approved by a person who has been designated by the Session as an "authorized requestor" for the fund.

The Passthru Benevolences group consists of funds that receive donations for a specific programs or activities that are provided by organizations other than FPUPC. The only disbursements permitted from these funds are periodic forwarding of donations that have been received to the intended recipient organization; these donations cannot be used by the church for any purpose whatever.

An example of a passthru benevolence fund is the One Great Hour of Sharing (OGHS) fund. Donations received for OGHS accumulate in this fund as they are received. The accumulated donations are then forwarded to Presbytery once donations to OGHS have tapered off and it appears that no more donations for OGHS will be received this year.

The Staging Accounts group consists of funds that receive donations or payments for activities or services that also incur expenses. Once the expenses associated with a particular activity or service have been accounted for, the net proceeds of the activity or service become income for another fund or for the operating budget. .

An example of a staging fund is Fellowship Hall Rentals. When somebody rents the hall for an activity, they make a down payment and a security deposit well in advance of the activity. The balance due on the rental is due two weeks prior to the activity. All activities require that a consultant from the church be present at the activity, and this consultant gets paid from the rental payments. The security deposit that was previously paid normally gets refunded after the activity takes place. Net income from rentals for which all expenses have been accounted for is periodically transferred to the operating budget.

The Special Events group is effectively a staging group for events and programs. Some of these programs/events are sponsored by the church and others are sponsored by organizations that FPUPC has close ties with (like the Dutchess County Interfaith Council). Finances for these events were previously accounted for in generic funds like “Fund Ventures” and “Special Events” and a separate process was needed to associate income and expenses with a specific event or program. Individual funds will now be created in the new Special Events group to track income and expenses for each individual event, eliminating the need to use a separate process to perform this function.

The Non-Participating Accounts group consists of funds that are used to implement accounting techniques for moving money from one fund to another without having this fund movement appear to as income and/or an expense that does not really exist. This is one aspect on non-profit accounting that does not exist in for-profit accounting.

The Expense to Income Transfers fund one such fund. It is used when an internal funds transfer must appear as an expense in the originating fund and as income in the receiving fund. Movement of money from one fund to another does not, however, result in actual income or an actual expense; i.e., no money actually either come into the church or left the church. Moving money from one fund to another through the Expense to Income Transfers fund provides offsetting negative expense and income transactions that cancel out the non-existent income and expense that would otherwise appear on the books.

The Operating Budget Reconciliation fund provides a time buffer for closing out the yearly operating budget. It normally has a negative balance at the end of the year and this balance is the amount that will eventually need to be withdrawn from FPUPC’s invested funds to close out the year’s operating budget.

Any year-end surplus or deficit in the General Operating fund is transferred to the Operating Budget Reconciliation fund at the end of the fiscal year so that the year-end balance of the General Operating fund ends up being zero as required.

It usually takes several weeks into a new year before the previous year’s financial activity finally settles down, and any withdrawals of invested funds that may be required to close out the prior fiscal year must be approved by the Session before they can take place.

The use of the Operating Budget Reconciliation fund allows “paper” journal entries instead of actual fund transfers to be used to deal with the inevitable late-breaking adjustments to the prior year’s operating budget during the somewhat dynamic year-end closing process. Actual transfer of funds then takes place once the prior year activity has stabilized and a year-end closing plan has been approved by Session.

You may also have noticed negative numbers sometimes appear on some lines in the Receipts and Disbursements columns of the Fund Activity report. Negative income and/or negative expense occur when journal entries are used to move funds between fund accounts and budget accounts. Use of this accounting practice is another accounting mechanism that is used to prevent fund-to-fund transfers from appearing as income and expenses that do not really exist.

Part of the reason for what sounds like accounting flim-flam is that the financial reports that the church runs on are specific to their intended audience. As an example, some of the income that the Nursery School receives is periodically transferred to the Church Operating Budget as payment for the services that the Church provides for the Nursery School (e.g., electricity, heat, water, insurance, phones and internet access, etc.).

From Session's point of view, they want to see this fund transfer as income to the church's operating budget. The nursery school co-directors want to see this as an expense in their operating budget. But no money came into or left the church as a result of these transactions and standard financial statements like Balance Sheets and Income and Expense that cover the entire church corporation as an entity must reflect this reality. Hence, we have strange funds like Expense to Income Transfers and negative numbers in the Receipts and Disbursements columns of our financial reports.

2020 OPERATING BUDGET YEAR-END RESULTS Report

2020 was obviously not a normal year for church finances. The need to discontinue in-person worship services and other uses of church buildings and parking facilities significantly distorted anticipated operating budget income and expenses.

Fortunately, income from offerings remained strong and ended the year at 96.4% of budget expectations. However, income from use of facilities (building rentals, parking permits, nursery school) declined significantly and ended the year at only 43.8% of budget expectations.

In 2020, external operating income amounted to $342,639 and operating expenses amounted to $454,284. This would normally have left us with an initial operating shortfall of $111,645.

The church applied for a Payroll Protection Program ("PPP") loan of $72,000 and received a loan of $49,900. The loan was deposited in an interest-bearing checking account and earned $22 in interest before the loan proceeds were completely used. The proceeds of the loan were used to cover $35,658 of church staff payroll expenses and $14,264 of nursery school staff payroll expenses.

The PPP loan reduced the 2020 church initial operating budget shortfall to $75,987. This shortfall was covered by using $1,050 from parking permit income, $1,750 from nursery school income, $920 from a fund specifically targeted for building repairs, $17,096 from the School of Sacred Music grant provided by Presbytery, $5,280 from the Vocational Scholarships invested fund, and $49,981 from the church's invested funds.

The 2020 budget authorized the withdrawal of up to $85,000 from invested funds to support the operating budget. As a result of reduced operating expenses and the PPP loan, only $45,981 will need to be withdrawn from invested funds to close out the 2020 operating budget.

In 2019, external operating income amounted to $342,639 and operating expenses amounted to $418,826, leaving us with an operating shortfall of $97,754 at the end of 2019. This shortfall was covered by using $13,350 from parking permit income, $7,000 from Nursery School income, $1,200 from a fund specifically targeted for building upkeep and improvement, and $67,704 from the church's invested funds.

The 2019 budget authorized the withdrawal of up to $81,200 from invested funds to support the operating budget. We were again fortunate that the amount that actually needed to be withdrawn from invested funds to close out the 2019 operating budget was $13,496 less than the budgeted amount that we expected to have to withdraw.

Operating Income

The following are the more important income line items that ended the year either over or under budget by more than $500 or by more than 20% of budget in 2020.

Regular Offerings – Fell short of budgeted amount by $8,634. The congregation lost very generous donors during 2020 and this accounted for most of this shortfall. The pandemic did not significantly impact Regular Offering income.

Holiday Offerings – Exceeded budgeted amount by $2,120. The Easter and Christmas offerings both included an unusually large donation that might have been intended to be Regular Offerings.

Undesignated Offerings – Fell short of budgeted amount by $4,897. This income consists primarily of loose cash in the Sunday offering plates. Since it became necessary to discontinue in-person worship in mid-March, this source of income effectively dried up at that point.

Other income treated as Undesignated Offerings include periodic distributions from the Amazon Smile program and donations received through portals such as YourCause and Benevity.

Per Capita Offerings – Fell short of budgeted amount by $574.

Used Clothing Drop-Off – Exceeded budgeted amount by $1,606. This has turned out to be an unexpected "cash cow" for the church. Income received from this source exceeded budget expectations even though the shed had to be closed for several months as a result of international travel and shipping restrictions resulting from the pandemic.

Use of Facilities – Fell short of budgeted amount by $6,981. Most rentals of Fellowship Hall that were scheduled to take place after mid-March were cancelled and all deposits and partial payments on these rentals were refunded. The payments made by Congregation Shir Chadash for their use of the church's facilities were also reduced by 50% in late spring since they too were unable to conduct in-person worship services at the church.

Parking Permits – Fell short of budgeted amount by $8,950. Students who had purchased parking permits were unable to use them once Arlington High School had to go to remote learning in March. It was deemed appropriate to offer refunds of parking permit fees that were intended to cover the months of April, May, and June ($105 per permit). The only income derived from parking permits in 2020 came from permit holders who elected to donate the refund that they were offered to the church.

School of Sacred Music Grant – Funds from the grant are transferred into the operating budget only as SSM expenses are actually incurred. Amounts budgeted for Additional Teachers and Guest Musicians were not spent in 2020. These amounts remain available for use in future years.

Nursery School – Fell short of budgeted amount by $5,250. The nursery school was forced to discontinue on-site activities in mid-March and did not receive any tuition income for the months of April, May, and June. They were unable to make their scheduled payment to the church at the end of July. The nursery school did resume limited operation in September, but Covid-related restrictions on class size and physical distancing reduced the amount of income they will be receiving. Their normally scheduled payment to the church of $3,500 in December was correspondingly reduced to $1,750.

<u>Operating Expenses</u>

The following expense items line items came in either over or under budget by more than $500 or 20% of their budget in 2020 or are items that I thought are worthy of bringing to your attention.

Salaries – All salary line items came in well under budget in 2020 since most payroll expenses for the period beginning April 23 and ending June 17 were funded by a federal Payroll Protection Program (“PPP”) loan. FPUPC applied for a loan of $72,000 and received a loan of $49,900. Of this amount, $35,658 was used for church staff payroll expenses and the remainder was used for nursery school staff payroll expenses. All church and nursery school staff members received their full salaries during this eight-week period.

The portion of the PPP loan that FPUPC applied for but did not receive was the result of lack of a definitive position on the part of the Small Business Administration (the “SBA”) as to whether or not clergy housing allowances were considered to be a valid payroll expense. Our lender (Hudson Valley Credit Union) erred on the side of caution and excluded these expenses from the loan that they granted us. The SBA subsequently issued guidance that clergy housing allowances were indeed valid payroll expenses. Since FPUPC had already received its PPP loan by this time, it was no longer possible to obtain the additional $22,100 that it should have received. Fortunately, the church’s income remained strong during the pandemic and it ended the year in sound financial shape even though it did not receive the full amount of the PPP loan that it applied for.

Insurance – Over budget by $1,708 or 13% in 2020. The premium for the church’s property, liability, and umbrella insurance coverage increased by 20% for 2021. The first quarterly premium payment for 2021 coverage was due in December, 2020, and was thus a 2020 expense. There was also a slight increase in the property insurance premium when FPUPC became the proud owner of a “lucky” Steinway grand piano.

This line item also includes property and liability coverage for the associate pastor’s residence, “umbrella” liability coverage and the net cost workers’ compensation, mandatory disability, and paid family leave coverage for church employees. The nursery school reimburses the church for the cost of workers’ compensation, mandatory disability, and paid family leave coverage for nursery school employees.

The cost of New York State mandated Paid Family Leave coverage increased significantly in 2021. The church is required to pay the full cost of this coverage “up front” in December of the preceding year, and then recovers this cost by payroll deductions during the year that this coverage is provided. The increased PFL premium pre-payment also contributed to insurance expense ending up over budget.

Electricity – Under budget by $1,424 (59%). This was primarily the result of the solar panels and a not-much-snow winter and secondarily as a result of reduced building use. The solar panels provided more than enough electricity to power the church buildings from April, 2020 through October, 2020 and sent some surplus energy down the wires to help keep the lights on, the food cold, and the cash registers running at Tops during these months. The church received a credit of $93 on its electric bill in November for net electricity exported to the utility grid during the year.

This expense is difficult to predict since it is weather-dependent. Solar panels don't produce a lot of electricity on cloudy days and produce no electricity at all when they are covered by snow. Most of the electricity they produce on hot summer days gets used by the church's air conditioners.

Heating – Under budget by $1,401 (23%). This was primarily the result of a milder than usual winter. This line item also includes the cost of gas used by cooking appliances which was lower than normal as a result of reduced building use. This expense is highly weather-dependent so it remains prudent to budget for it conservatively.

Environmental Services – Under budget by $4,686 (50%), A substantial portion of this line item is for supplemental cleaning services that were provided by The ARC of Dutchess. The use of these services had to be discontinued in mid-March due to the closure of our buildings. Additional funds were also included in this budget item to pay for one-time cleaning services. Most of these funds were not spent as a result of the building closures.

Grounds Maintenance – Under budget by $5,378 (49%). Once again, the result of a mostly snowless winter. On should, however, keep in mind that a single heavy snowstorm can set the church back $1,500. This budget item also includes lawn mowing expense.

Kitchen and Custodial Supplies – Under budget by $1,609 (46%). Savings entirely the result of reduced building use.

Furniture, Equipment, and Organ – Under budget by $343 (24%). Planned upgrades to the church's computers deferred until 2021.

Church School – Under budget $1,505 (84%). Sunday Church School had to be suspended in mid-March as a result of the mandated building closures.

Health Ministry, Special Programs, Coffee Hour, Music, School of Sacred Music Supplies – All significantly under budget as a result of the suspension of in-person worship services and mandated building closures resulting from the pandemic.

Building Maintenance / Repairs – Under budget by $1,396 or 56%. No unexpected expenses during 2020. Much of the amount spent in this category was used to purchase special air filters for the HVAC systems that service the sanctuary and new buildings. The new air filters are capable of trapping the Coronavirus.

2021 OPERATING BUDGET **Report**

The actual expends for several line items in the budget fluctuate significantly from year to year, and only looking at the previous year's actual expends does not always provide a realistic projection of what to expect in the coming year. The "2015-2019 Average FY Actuals" column provides additional input for determining appropriate budget amounts for line items that don't behave consistently from year to year.

Operating Income

Regular Offerings - The amount budgeted for Regular Offerings is primarily determined by a mathematical model that analyzes individual giving patterns for the past five years and amounts pledged for the coming year to project the income can be expected for regular offerings in the coming year. The model predicts that we can reasonably expect $317,800 in regular offering income in 2021. The details of the analysis that determined the amount budgeted for 2021 Regular Offerings can be found in the 2021 Pledge / Giving report.

Holiday Offerings – Budgeted amount increased primarily based on actual 2020 Holiday Offerings.

Per Capita Offerings – Budgeted amount slightly decreased based on the actual amount donated in 2020.

Undesignated Offerings – Budgeted amount decreased since this income is largely dependent on being able to conduct well-attended in-person worship services and that is not expected to happen until at least September. .

Use of Facilities – Decreased based reduction in rental income that the church will be receiving from Congregation Shir Chadash in 2021 and the expectation that income from rentals of Fellowship Hall will be minimal in 2021. .

Parking Permits – Decreased based on the expectation that this source of income will not return to normal levels until September – if then.

Used Clothing Drop-Off – Increased based on income that is actually being received from the shed. The budgeted amount may even be pessimistic. Income from this source is, however, dependent on being able to ship the collected items to be sold in other countries. Any restrictions that may be imposed on such shipping will adversely affect this income.

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School of Sacred Music Grant – As previously mentioned, funds from the SSM grant are only transferred into the operating budget as actual SSM expenses are incurred. Consequently, this item has a net zero effect on the budget.

Invested Funds – The amount budgeted for invested funds is what is necessary to bring the budget into balance. It's the difference between total budgeted expenses and all other sources of budgeted income. There is, however, a limit on the amount that can be withdrawn from invested funds each year to support the operating budget. More details about that in the Invested Funds section of this document.

Vocational Scholarships - FPUPC will continue to host a seminarian in 2021. Her entire salary will be paid by withdrawals from the Vocational Scholarships fund, making this a net zero item in the operating budget.

Operating Expenses

Salaries

The Presbytery has recommended a 1.3% cost of living salary increase for our ministers. The personnel committee concurs with this recommendation and has also recommended that our support staff (parish nurse, administrative assistant and sexton) receive the same 1.3% salary increase that Presbytery recommended for our ministers.

Rev. Lent came across a unique opportunity for continuing education and asked that his Study Stipend be increased to $2,000 in 2021 in lieu of the 1.3% cost of living salary increase. The Personnel Committee and Session endorsed this request.

The work schedule for the Administrative Assistant has been reduced from 25 hours per week to 20 hours per week until the second week in September when it will go back to 25 hours per week. The amount budgeted for the Administrative Assistant's salary has been adjusted accordingly.

The amounts budgeted for the salaries of employees whose work hours depend on in-person worship services being conducted on Sunday mornings have also been reduced. These employees include the Parish Nurse and the Child Care providers. The church has previously agreed that the Parish Nurse will be paid for all hours worked even if the budgeted amount for this salary is exceeded. It is not anticipated that child care services will be needed until at least September.

Operations

Insurance – As previously mentioned, the premium for the church's property, liability, and umbrella insurance has increased by 20% for 2021. 2020 has been a particularly bad year for insurance companies due to the increase in claims arising directly or indirectly from the pandemic. Liability insurance premiums have increased as a result.

Electricity - The amount budgeted for Electricity has been decreased based on our experience with the solar panels, and the expectation that building use will continue to be limited for most of 2021.

Heating – The amount budgeted for Heating has been slightly reduced based on the expectation that building use will continue to be limited for most of 2021.

Water – Most of the amount budgeted for water is for water district taxes. For reasons that I can't explain, these taxes seem to be decreasing from year to year.

Environmental Services (garbage, additional cleaning, exterminating, fire alarm system monitoring, inspection, and servicing) – The amount budgeted for these services is based on the assumption that the church will not be rehiring The ARC of Dutchess for additional weekly cleaning services and that previously planned additional cleaning services will not be done in 2021 due to decreased building use.

Grounds Maintenance – This is always the great unknown in our budget, as this expense is a big one and depends very heavily on how much snow, sleet, and freezing rain falls in any given winter. FPUPC has gotten off reasonably cheaply for the past few years but the old adage about past performance not being a guarantee of future results definitely applies here. The amount budgeted assumes a normal winter in terms of snowfall.

Kitchen and Custodial Supplies – Budgeted amount reduced based on the expectation that building use will continue to be limited in 2021.

Benevolences

The amount budgeted for all items in this category is the same as it was for 2020.

Programs

Church School – Budgeted amount decreased by $1,000 since it appears unlikely that Sunday Church School will be resumed any earlier than September.

Health Ministry, Special Programs, Coffee Hour, School of Sacred Music Supplies – Budgeted amounts decreased by 50% from normal levels as a result of the suspension of in-person worship and reduction in building use,

Music – Budgeted amount decreased by 40% based on actual 2020 expends and the expectation that the choirs will not resume normal activities until September.

Deacons, Staff Appreciation – Budgeted amounts unchanged from 2020. .

Maintenance / Repairs

The amounts budgeted for items in this category are unchanged from what they were in 2020. Expenses in this category are expected to be fully funded by transfers from the Building Repairs grant and the Maintenance invested fund making this a zero net item in the operating budget.

INVESTED FUNDS Report

FPUPC's investment portfolio consists of 12 individual invested fund accounts, each of which represents money donated to the church either for a specific purpose or for general use. The invested funds report shows how the church's total investment portfolio is distributed across the individual invested fund accounts.

The combined assets of the 12 invested fund accounts are pooled and invested in three investment asset accounts: a stable income "Legacy Bond" account at Merrill Lynch, a "Managed Account" account at BlackRock / Merrill Lynch, and a promissory note on the associate pastor's residence. The total value of FPUPC's investment portfolio was approximately $2.43M at the end of 2020, as compared to $2.20M at the end of 2019.

The Legacy Bond account is self-managed; we tell Merrill Lynch when to buy and sell bonds and what bonds to buy and sell. The managed account is professionally managed for a fee. It was decided by session last year that we should move toward having all of our bond and equity assets professionally managed.

This decision is being implemented on a staged basis. Bonds that are providing a good return on investment (i.e., > 3%) will remain in the Legacy Bond account until they mature or are called. Two bonds worth a total of $65,000 matured in 2020 and this amount was then transferred to the Managed Account to be invested in bonds.

Our investment advisors at Merrill Lynch recommend that an investment mix of 25% stable income and 75% equities remains appropriate for FPUPC's investment portfolio. Their recommendation has been accepted by the finance committee and session. The stable income portion of the investment portfolio consists of cash, bonds, and the promissory note on the associate pastor's residence. Some of the bonds will be in the Legacy Bond account and some will be in the Managed account. The equity portion of the portfolio includes both individual stocks and exchange-traded funds (ETFs).

The Invested Funds report new includes a table that summarizes the ending balance of the three investment asset accounts as of 12/31/2020 and their time-weighted rate of return in 2020. It also provides similar information for the Dow and the S&P 500 as a basis for comparison.

The table also includes time-weighted rates of return from 1/26/2018 to 12/31/2020 and you might ask why this is measurement is relevant. The simple answer is that it probably no longer is, but it was necessary to accurately provide a more realistic picture of market gains and losses last year.

The stock markets tanked in the closing days of 2018 and then proceeded to recover to more normal levels in the early days of 2019. As a result, the starting point for measuring market performance in 2019 was unrealistically low resulting in euphoric market "gains" in 2019 that were drastically overstated.

The Dow peaked at 26,616.71 and the S&P 500 peaked at 2,872.97 on 1/26/18. The Dow started 2019 at 23,333.19 and the S&P 500 started 2019 at 2,507.79. The Dow did not get back above 26,616 and did not consistently stay above that number until July, 2019. The S&P 500 did not get back above 2,845 and consistently stay above that number until mid-April of 2019. However, both of these indices once again tanked on 3/20/2020 when the United States discovered that the Coronavirus was not "fake news". Dow down to 19,173,98and S&P 500 down to 2,304.92. Both averages finally climbed back above where they were on 1/26/18 at the beginning of May, 2020, and have been consistently climbing since then. If you bought a typical stock on 1/26/18 and sold it on 5/1/20, your net gain would have been zero.

Meanwhile, the Dow was up by nearly 22% and the S&P 500 was up by nearly 29% in 2019, based on the abnormally low values that they were at on 1/1/19. Using 1/26/18 as a starting point, the Dow only went up by 7% and the S&P 500 only went up by 12.5% over this longer period.

Both the Dow and the S&P are now well above where they were on 1/26/18 and it appears that they will remain at these high levels in spite of what is going on in the real world outside of Wall Street. Consequently, year-to-date measurements have once again become a meaningful barometer of market gains and losses and it may no longer be necessary to look back to early 2018 to get a realistic picture of market performance.

FPUPC's investment portfolio did considerably better than the Dow and came close to matching the S&P 500 in 2020. From all outward appearances, the portfolio contains the right mix of assets and is being well managed.

As with any loan, the asset value of the promissory note decreased by $9.3K in 2020 as principal payments were made on it. These principal payments and the interest earned on the note were distributed to the individual invested funds based on their current balances. In effect, part of what was an accounts payable asset was converted into a cash equivalent asset with no net change in total asset value.

<u>Restrictions on the Use of Invested Funds</u>

Restrictions can be placed on how and when funds donated to the church can be used by either the donor or by the session. The first and foremost of these is restricting the purpose for which the donated funds can be used. If a donor specifies that a donation they wish to make is intended to be used for a specific purpose and the church accepts the donation, the church and its treasurer are legally obligated to ensure that the donation will only be used in a manner that is consistent with the donor-imposed restrictions on it.

A donor can also specify that a donation they wish to make is to be an endowment. In this case, the donation is expected to be invested in a manner that will produce a return by generating income such as interest and dividends and/or by increasing in value. The originally donated amount becomes a "permanently restricted" asset of the church and cannot be used for any purpose other than being invested to generate income and/or increase in value. The donor may also restrict the use of the returns on this investment or may allow the returns on the investment to be used by the church in any manner that the session deems appropriate.

Another way the use of a donation can be restricted is by placing limits on how much of the donation can be used by the church in a given time period. For example, a donor could state that only 5% of the donated amount can be used in any 12-month period. Placing restrictions of this type on a donation (or on the returns produced by an endowment) helps ensure that the donation will continue to provide a source of funds for the church for an extended period and not be used to satisfy a short-term need.

The session is also at liberty to place any or all of the above restrictions on donations received by the church, but any such action taken by the session can subsequently be amended or reversed by the session. This is not, however, the case when donor-imposed restrictions are placed on the use of a donation. The session is not at liberty to amend or ignore donor-imposed restrictions on a donation without first having obtained the permission of the donor (or somebody who is legally authorized to act on their behalf) or the Attorney General of New York State to do so (Ref: New York Nonprofit Revitalization Act of 2013).

All of the above restrictions come into play when dealing with FPUPC's invested funds. Some of the funds can be used only for a specific purpose while others can be used as deemed appropriate by the session. Some of the funds are donations while others are endowments. And session has imposed limits on the rate at which the invested funds can be used.

Our investment advisors strongly recommend that not more than 5% of the balance of any invested fund be withdrawn in any given year. The finance committee, church treasurer, and pastor all agree that this is the maximum amount can be safely withdrawn from the investment accounts each year without impacting their ability to produce income that will be needed in future years. This restriction will be referred to as the "5% Rule" for the remainder of this discussion.

Based on the market downturn at the end of 2018 and the need to address some too-long-deferred building maintenance, it has become necessary to plan to withdraw more than 5% of the eligible invested fund balances to balance the 2019 budget. This was a one-time situation that will not re-occur in future years. With considerable help from the PPP loan, the 2020 operating budget was balanced without coming anywhere near exceeding the 5% rule.

A Guided Tour of the Invested Funds Report

The YTD Summary page of the invested funds report attempts to display all of this complexity as clearly as possible, but this isn't an easy task. So here's a guided tour of the report.

The report categorizes each individual invested fund as an endowment or as an unrestricted gift based on the donor's intent. While the permanently restricted amount of endowed funds is not shown on the report, it is factored into the computation of the amounts that can be withdrawn from endowed funds.

The "Value 12/31/2019" column shows the balance of each individual invested fund as of the end of the preceding calendar year (or as of the beginning of the current calendar year if you prefer to think of it that way). The "Available Funds 1/1/2020" column shows the maximum amount that can be withdrawn from each individual invested fund during the 2020 current calendar year based on the 5% Rule. With the exception of the Vocational Scholarships fund (which has its own set of rules), this amount will be the lessor of (1) 5% of the balance of the fund as of the beginning of the year, or (2) the difference between the balance of the fund as of the beginning of the year and the permanently restricted amount (if any) of the fund. Note that permanently restricted amounts apply only to endowments.

The "Available to Operating Budget as of 1/1/2020" column shows the maximum amount that can be withdrawn from each individual fund to support the 2020 operating budget based on the 5% rule. The entry in this column for each fund will either be (1) a non-zero dollar amount, (2) $0, or (3) an empty cell with no value in it.

An empty cell in this column indicates that withdrawals cannot be made from this fund for use in the operating budget. A value of $0 indicates that there are no expenses in the current operating budget that are consistent with the intended use of the fund. A non-zero value specifies the maximum amount that could be withdrawn from the fund to support operating budget expenses that are consistent with the intended use of the fund.

For example, the "Available Funds 1/1/2020" column shows that $19,510 is available for withdrawal from the Vocational Scholarships fund. There is, however, an empty cell in "Available to Operating Budget as of 1/1/2020" column for this fund. Consequently, any withdrawals from the Vocational Scholarships fund can only be used to provide vocational scholarships and this expense is not normally part of the operating budget.

The "Available Funds 1/1/2019" column shows that $1,370 is available for withdrawal from the Maintenance fund and the "Available to Operating Budget as of 1/1/2019" column shows that the same amount can be used to support the operating budget. However, any withdrawal from the Maintenance fund can only be used to offset Maintenance/Repairs items in the budget. Consequently, withdrawals cannot be made from the Maintenance invested fund until eligible expenses have been incurred in the operating budget.

And, lastly, both the "Available Funds 1/1/2020" column and the "Available to Operating Budget as of 1/1/2020" column show that $32,430 is available for withdrawal from the General

– Income Only fund. Since no restrictions have been placed on the use of income produced by this pseudo-endowment, the entire $32,430 can be used for any purpose including general funding for the 2020 operating budget.

The income column shows interest and dividends generated by the investments. The expense column shows the broker's fees for managing the investment asset accounts. The gain/(loss) column shows the change in market value of the investments.

The "Value mm/dd/2020" column shows the value of the invested funds as of the end of the month for which the report was generated. The "Available Funds mm/dd/2020" column shows the amounts that are available for withdrawal from the various funds at the end of the month for which the report was generated. For each fund, it will be the amount that was available for withdrawal at the beginning of the year minus any withdrawals that were made so far this year.

The "Available to Close 2020 Operating Budget" column shows the amounts that still can be withdrawn from the various funds to close the operating budget as of the end of the month for which the report was generated. The meaning of empty cells and $0 values is the same for this column as it is for the "Available to Operating Budget as of 1/1/2020" column.

The "Remaining Planned 2020 Withdrawals" shows amounts that we expect to be withdrawing from the various invested funds for the remainder of the year and to close out the 2020 operating budget early in 2021. This information is used to estimate a balance for each invested fund at the beginning of 2021 on which estimates of amounts available for withdrawal in 2021 can be computed.

And, finally, the "Available Funds 1/1/2021" and "Available to Use in 2021 Operating Budget" columns provide these amounts for 2020.

For those viewing the Excel (.xls) version of this report, additional details about the withdrawals that were made from the various funds can be viewed by un-hiding the columns between column M and column W. A detailed list of the withdrawals made from the invested funds can be found on the Transactions tab of the worksheet.

Major Withdrawals

A total of $23,521 was withdrawn from eligible invested funds in early 2020 to cover the remaining 2019 operating budget shortfall. $4,952 was withdrawn from eligible invested funds during the year to help cover 2020 operating expenses. $6,080 was withdrawn from the Vocational Scholarship fund. Of this amount, $5,280 was used to pay 50% of the seminarian's salary.

A total of approximately $49,891 will be withdrawn shortly from various invested funds to close out the 2020 operating budget.

A complete list of withdrawals that have been made from the invested funds can be found on the Transactions tab (second page) of the invested funds report.

Some Statistics

The combined balance of the invested funds that can be used to support the operating budget was $1,923,568 as of January 1, 2020. Based on the "5% rule", a total of $93.920 was available for withdrawal from eligible invested funds to support the 2019 operating budget. However, the approved 2019 operating budget only required that $85.000 be withdrawn from invested funds in order to achieve a balanced budget. This amount is 4.42% of the combined balance of the eligible invested funds.

At the end of the year, it turned out that it was only necessary to withdraw $49,891 from invested funds to close out the operating budget. This amounted to 2.59% of the combined balance of the eligible invested funds.

The combined balance of the invested funds that can be used to support the operating budget was $2,078,242 as of January 1, 2021. Based on the 5% Rule, a total of $101,500 can be withdrawn from eligible invested funds to support the 2021 operating budget. However, the approved 2021 operating budget only required that $98,600 be withdrawn from invested funds in order to achieve a balanced budget. This amount is 4.74% of the combined balance of the eligible invested funds.

FPUPC is living within its means!

ANY QUESTIONS?

Please be encouraged to ask them during the financial presentations at the congregational meeting. If you would like answers to your questions before the congregational meeting, you can e-mail them to treasurer@fppchurch.org.