Pastoral Skills_ Finances, Legal, and Admin Issues

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Hello. By way of introduction, my name is Scott Kregel, and I am a CPA with an accounting and tax practice. We have a team of 12, and we work primarily with small businesses and their owners, both in the professional services space and the real estate industry. Now, previously, I had served on staff at a larger church that had some affiliated nonprofit organizations, and I was involved in the areas of finance and operations, which included the building, the human resources, capital campaign, construction management types of things.

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So I'm thrilled to be sharing with you a little bit here about church finances and finances related to... to members of the clergy. So we have this image sitting... over top of the doorway leading into our garage, and it says, do hard things. And so every day, every one of our family members walks through this opening, and it's.

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just a daily reminder to ourselves that, hey, there are hard things in our lives. So now certainly, there's a spectrum of hard things, and I don't want to, you know, try to make judgment there, but I'm going to say in this case today, I'm going to put it out there that for some of you, finances, particularly church finances, is one of those hard things, right? And I can also be probably fairly certain that many of you did not include organization.

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finances or any of those things in your core curriculum related to your seminary studies or other pastoral training. So... Okay. So let's get into it. But, you know, finances... are for finance people, right? Well, I think I want to impress with you that understanding finances is also for everyone, and particularly for those in ministry and for you as a leader. So this sign, you know, do hard things,

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is really a statement and a good reminder for all of us. We might not be able to make church finances easy, but I hope that you will walk away from this session with a much better understanding and appreciation for all that is involved with church finances and the unique financial considerations for members of the clergy. So we're going to first go into addressing things, that are overall important for pastors.

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and the things that they need to understand about finances in ministry that relate to stewardship, financial records, TPs. financial budgeting, and then your ministerial status. So no doubt questions and situations are going to come to mind while we're working through here. So let me encourage you to just write those things down. And so maybe as we work through these different matters, you might find an answer or maybe not,

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but at least you'll have those items in a format and on your mind that you can reference back to and reach out to people that may be able to help you help address that. So first off is stewardship. I want us to start with stewardship, as I believe this is such an important foundational area to start with when working through finances in most any situation. So by way of definition, I see stewardship as the job of supervising, or taking care of something.

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You are leaders, you're supervising and taking care. of people in your church, of your organization. So as someone leading well here, the following principles should be guiding you. There's a principle of ownership. There's a principle of responsibility and a principle of accountability. With ownership, you know, in the beginning, God created. So remember, God created. We did not. So we're here to care for God's creation,

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which is one another, our physical resources, and the blessings in our lives. This is a good reminder of the principle of ownership. Then we have the principle of responsibility. And so owners have rights, but stewards have responsibilities. And then last is the principle of accountability. And so we all know the parable of the talents, where to whom much is given, much is required. Well, accountability is really important to build trust.

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and having that perspective, really helps us. and better understanding why we want to follow good processes and good systems in our finances. Now, let's not lie. Stewardship is also about fundraising. Your organization needs money. Now, what do people give money to? Well, most people are more motivated by the mission of the organization than the building or the expense of the organization. So one of your key functions as a pastor is to cast that vision.

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As a leader in your church, you will be called on to ask for the amounts needed to accomplish your core functions of your church as well as your aspirational goals. Teach that giving is an act of worship. Teach people to worship with their money. There are so many life lessons for people as they grow in their understanding and practice of stewardship. So just as you are interested in helping others in discipleship or missional living,

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Help others learn the joy of giving and that everything they have is a blessing from God. So next is financial record keeping. Now with financial record keeping, I believe order is important. I see order as an act of worship. It's part of your administrative and financial operations and have them ordered as a reflection in your reverence in worshiping God.

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It's also a demonstration of respect and care for your church body. And you're honoring others by stewarding and taking care of the gifts entrusted to you and your organization. And then three, to gain confidence from others in leadership, whether this is your board and others on your staff. So it builds, it's responsible, it builds trusting, it builds trusting confidence. And so what is your... role as the pastor. You might say finances are not my thing. Well, it's probably a hard thing,

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right? So here's some ideas for you then. Commit to finding an individual or two that are comfortable in the areas of church finances. Build an intentional relationship here and allow them to use their gifts to help you as well as to help your church. But at the same time, be an intelligent reader of the financial statements of your church. Know what you're looking at when someone shares you a summary of your church finances.

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So here's an example of what I would consider to be clean church financial statements. So on your screen is first a statement of activity. This is like an income statement for a church. And so your contributions to the church is your revenue or your income. And that might be unrestricted operating. Fund gifts or maybe restricted or, you know, missions or specific targeted gifts.

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And then you have your expenses, which might involve your personnel, your salaries, maybe some ministry expenses, and then some just operational expenses. So when you subtotal the income, the contributions and subtotal the expenses, you take your total income, less your total expenses, gives you your net change or change in net assets, which is really your profit or loss. The second statement that you want to understand is your organizational statement of financial.

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position. This is like your balance sheet. And so this statement is going to reflect the balances in your checking accounts or investment accounts. So you might have a savings account. And a checking account. and maybe a money market or something like that. You might also reflect if you own a building or have a number of what are considered fixed assets, you would show that property and equipment in the assets section of your statement of financial position.

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Liabilities really represent those things that you owe somebody else. And so you

might have maybe a credit card or you might have some bills that you owe other vendors and so forth and that's included in like your accounts payable. And, you know, it's possible that you have some bank financing, maybe a bank loan of some kind, and that would be called like a notes payable. And so those things are inside your liabilities section on your statement of financial position.

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And then the bottom section is termed your net assets. And this... is kind of translated to retained earnings. for a business and this is the accumulation of all your prior year's net profits, accumulated year after year after year. Typically you want to see that your net assets are equal to the amount of cash less any kind of liabilities that you may owe to other people.

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and that would represent your net assets. So in the role of the pastor the last piece is understanding cash flow and that's largely a matter of spending less than what actually comes in and so you know this is we're going to learn a little bit more about that in budgeting. So again one of your most important roles is to align yourself with someone who can shoulder the responsibility of your organization finances. This is a unique individual and someone who you want to be careful not just to.

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you know, dump the financial burden on, but someone that you can see as a very strategic partner in the leadership of your church. So what are some of the tools or processes for accurate and effective record keeping? Now, in full disclosure here, some of these ideas represent, I guess, a bit of a bias relative to my own appreciation of a certain technology stack that I think works really well for a church's back office accounting functions. First is a.

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general ledger accounting system called Xero, and it's xero.com, and it's a fantastic cloud-based accounting system that you can track your organization finances. Next would be Receipt Bank. This is a wonderful digital document capture expense receipt tracking tool that, you know, is an application. You can tap on your phone and you can capture all your expenses. is there. ADP Payroll. This is a reliable payroll processing tool that can administer regular payroll.

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processing for your church. And they have functions and they have people that understand the unique characteristics for members of the clergy. And then Simple Church. This is a beautiful online system that can provide online giving as well as donor tracking and receiving for your donations. A last important measure for your church finances as well will be to make sure that you set.

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up separate organization bank accounts to really track your income and expenses. And sometimes that may involve keeping a bank account. And sometimes that may involve keeping a bank account. And sometimes that may

involve keeping a checking account as well as a savings account. You'll also want to have different people responsible for different functions. So maybe create a team that will collect donations and record in your church financial record-keeping system. They can help maintain those donor records.

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And then maybe have another individual or team that will be responsible for paying bills and running payroll to just help alleviate that burden of the church finances. So we've hit on both stewardship and financial record-keeping. Next is financial budgeting. So budgets are really a reasonable expectation of the cost to operate an organization. Now, budgets should be developed before your fiscal year starts.

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So just like when you're looking for maybe a new job or looking to move or buy a house, you're looking to buy a house. You spend some time thinking and imagining and putting on paper and weighing some of the various pros and cons of the... finances related to the decision. So that's what budgeting really involves. So for a financial calendar for a church, let's just say you have a January fiscal year start. During the month of January, you know, you're going to be using that time to.

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reconcile your income and expenses for the previous year, and then you also want to, in January, produce those year-end giving statements for your donors. I don't want you to miss also an opportunity to, remind and encourage your donors about the impact that their gifts are making on the organization that they're giving to. Now during the months of maybe February through July, you know, these are the times when you're really carrying out those programs and plans.

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from the prior year planning that you worked through maybe last fall. And you're really carrying out those actions. that you budgeted for and planned for. Now, the July to September time frame is really a time for the leadership to research, think, and create some ideas for your church and your ministry for the new year of January again through December. By October, you're starting to put some of these ideas on paper and into workable plans.

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and maybe some tentative finances included. During October and then even into November as well, you know, you're starting to review these financial plans and budgets with your leadership team and possibly your board. And then November and December, you're actually putting it all together into a financial budget. And then you'll communicate it again with your leadership teams and board as well as your church. And so with budgeting, there are really three ways that...

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look to budget. There's zero-based budgeting. This is really starting a budget without any influence of prior year actual spending. So this really involves asking

yourself, what amount of money will we need to pay our expenses today and even this month to help carry out our priorities? The next area would be a historical percentage-based budgeting. This is really the most common approach to budgeting that you see. And with that, organizations look at their prior year spending and they give themselves a little plus or minus, maybe a percentage or two or a certain dollar amount up and down in individual spending categories.

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And when you total that all up, that represents your budget. That's your budget change or your budget amount. type of budgeting is multiple year budgets. And these types of budgets are typically very aspirational and used for long-term initiatives or long-term planning. They often start with your baseline budget and then add in the new proposed initiative or project and then consider the financial modeling ramifications from it. So budgeting is an important annual process to.

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think and work through. This is your opportunity to put on paper the reality of your church's mission and your goals for the next year and even beyond. All right, our last section that we want to hit on here is related to individual pastor and clergy tax and financial matters. There's a lot involved here and we'll try to look at things from your pastor issues as it relates to your ministerial status, social security, and financial matters. And then we'll talk a little bit more taxes, housing allowance.

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And then I want to touch on a little bit about managing your personal finances, looking at what spending plans mean, a little bit about savings and investments, some things related to insurance, and then last, shortly on, estate planning. So in the ministerial status, or clergy status, there's some important things here. And in order to avail yourself of the special tax characteristics applicable to pastors, you must qualify for ministerial status, as provided for by the IRS.

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What does that mean? That really means you must be either ordained, commissioned, or licensed. Now, whether you are ordained, commissioned, or licensed is not as important. As. Whether or not you do the following. And these include administration. administering the sacraments, conducting regular worship, or have some kind of management responsibility. Now special rules do apply to members of religious orders or evangelists and.

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missionaries and those ministers who teach or work in denominational service. We won't get into that here. So one of those first pieces, social security taxes. Social security taxes are really made up of two types of taxes that are imposed on individuals and passers in this case. It's social security, which is about 6.2% of your income, and it provides a regular retirement.

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income stream to you. Medicare is about 1.45%, and this provides you with affordable health care. All right, so what is income earned by pastors, you know,

and what's clergy income and non-clergy income? So income earned by pastors in the exercise of formal ministry is subject to self-employment tax. And so when we're talking about that, we're, again, thinking of your pastoral role, your job as a pastor.

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Maybe income you earn from weddings or funerals or possibly some retreat-speaking income. Now, you may also have another job, you know, maybe a part-time job doing something else. And so that is income earned by pastors not in the exercise of formal ministry. And that's going to be subject to normal employment withholdings and related taxes. And so that might be, like, working at a hospital. Home Depot or some kind of other sideline job or doing work.

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not under the auspice of a non-profit organization. Another unique thing for members of the clergy is the opportunity to elect out of the Social Security tax system. Now, keep in mind that this requires some very important steps in the process. First is filing Form 4361, which is an irrevocable election. And it follows certain requirements laid out by the IRS.

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What they include are, you know, within the first two years of you earning more than $400 in ministerial income, again, think of that church job, wedding, funerals, retreat speaking, you must file this Form 4131 with the IRS. You must also inform your ordaining body or commissioning body, which is the one that you're in charge of. You must include your board members. or even your church members. And then you must also provide evidence of the tax-exempt status of your church.

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It's also really important to consider that once you opt out, this is irrevocable. So you must be sure to make alternate plans to provide for retirement, disability, death, things that Social Security and Medicare cover. And so that's where you may want to consider some of those other aspects. As a member of the clergy, the housing allowance is, again, a significant tax benefit available to you.

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So what is a housing allowance? The housing allowance allows you to exclude a portion of your salary from your taxable income. And so, for example, let's say you earn $40,000 and you have a $20,000 housing allowance. allowance. While you may earn $40,000, you only pay tax on $20,000 because the first $20,000 that's your housing allowance is subtracted from your taxable income. Now, the other benefit here is.

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that some of the expenses that you use towards that housing allowance, which is, again, already excluded from your taxable income, are also permitted to be deducted. Things like your home mortgage insurance and real estate taxes. So, this is really, you know, sort of a approved double dip for members of the clergy

because you're deducting expenses on your taxes that you've also excluded from your income. However, to be, in order to take advantage of this housing.

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allowance treatment, you must follow the process. And that process includes putting it in writing the amount of your housing allowance. The housing allowance must be approved by your church or your church board in advance of the period in which you're being paid. Now, approximately 90% of all clergy members utilize this housing allowance. And so make sure that you're taking advantage of this nice overall tax benefit for you.

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Let me tell you a story about Rick Warren. Now, many of us know Rick. If you don't, Rick was the founding pastor of a large church in California and also the author of The Purpose Driven Life. Now, Rick was involved in a lengthy IRS audit that resulted in the IRS disallowing a portion of his housing allowance. At the time, his total housing allowance was almost 90 to 100% of his total.

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And it was based upon his... his actual expenses incurred to provide for his home. Now, prior to 2002, the law was not very clear what fair rental value meant or actual expenses incurred meant. The tax case resulted in the IRS reaffirming that Warren was able to exclude his full housing allowance. But it did cause Congress to look at actually defining what this housing allowance did include.

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And Congress and the IRS came up with this criteria for determining what is your allowable housing allowance. And that amount each year is going to be the lesser of three things. The fair rental value of the home, the actual expenses incurred, or the amount designated by the church in advance. So when you work through claiming your housing allowance on your tax returns,

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You will need to substantiate all three of these amounts, and your tax return will only be able to claim the smallest of those amounts as your excludable housing allowance. Now, there's been some recent rulings as well that people have taken things to the tax courts to remove the housing allowance. In fact, there was a judge in Wisconsin who has tried a case both in 2013 and again in 2017, and that judge basically said that the housing allowance violates the Establishment Clause because it does not have a secular purpose or effect,

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meaning that it is a treatment only reserved for ministers in religious institutions, and it demonstrates a preference for ministers overseas. She's essentially correct, and she's agreeing with me. the people that brought the suit from the Freedom of Religion Foundation executive directors who have said this is discriminatory to people who are pastors and those of us.

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that are not pastors. They had been denied the housing allowance and they wanted to be on the same equal footing as pastors. Now, on both occasions, you know, there was a little bit of fear that, oh, it's going to eliminate the housing allowance for pastors. But even if this was upheld, her ruling would only apply to the district in which she governs, which is really Wisconsin, Illinois, and Indiana.

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And the ruling also did not apply to church parsonages, only to pastors who owned their homes. Now, in May of 2019, the Seventh Circuit Court of Appeals overturned, These rulings out of Wisconsin and declared the housing allowance as constitutional under the parameters currently in place. So this is a huge win for you as pastors and ensures that you can have the confidence in this valuable tax benefit for years to come.

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So those are some of those unique issues related, tax issues related to pastors. Now, I wanted to maybe spend a little time to share some thoughts around managing your own personal finances. So just like with your church finances and give it some of the priority that it deserves, you can be looking at your own personal finances in many of the same ways. Now, a general outline to maybe consider your personal finances really can involve first getting organized.

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Reconcile your bank accounts on a regular basis. Pay your bills on a regular basis. consistent timing. Set some goals as a family or as an individual. And then last, communicate and share them with your spouse and family or others close to you. Now, with managing those finances, I think, you know, instead of having budgets per se, I like to consider spending plans for people. And spending plans are really the allocation of your total income. Like I said, I don't like to.

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call our personal finances budgets because we don't really seek to determine how much money we need to operate. We really want to understand how to allocate our spending of the money we currently earn. So a simple idea for allocating your spending is what I might call the 50-30-20 rule, okay? So 50% of your income goes towards your needs. That's going to include your rent, Your mortgage, your automobile expenses, your groceries, utilities, maybe some student loan repayments.

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30% is going to go towards your wants. This might include, you know, clothes, a vacation, personal care items, entertainment type things, internet, TV. And then 20% is really for savings and maybe for giving as well. You know, and this includes your retirement plan savings, maybe some college savings and emergency funds. Now, I want to hit on as well just some general ideas as it relates to savings and investments.

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There are several types of investment vehicles out there. And I'm just going to walk through some of the more common ones that are out there. Stocks, these really represent ownership that you have in another company. You are really a part owner in a corporation. They will pay you dividends. And often, as the stock price rises or falls, you will realize gains or losses when you dispose of the stock. Bonds are similar in the sense, but they represent loans that you make to maybe the government or to another corporation.

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And they pay you interest for borrowing your money. Cash is really just an area where you hold in a checking or savings account or maybe a money market account. And this also includes certificates of deposits maybe that a bank might have. And then mutual funds are another savings and investment vehicle. And these represent really a mixture of the three that I just mentioned. A stock mutual fund is going to have purchased several individual stocks or bonds or a combination and group them together as a mutual fund.

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You then are purchasing a piece of the stocks and bonds. That the mutual fund has purchased. Often these investments allow you to systematically continue to purchase on a regular basis without, you know, incurring big, large, you know, brokerage fees. Retirement. Retirement plans for an employee in a nonprofit is really referred to as a 403B plan versus a 401K plan for a regular for-profit business.

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The differentiation is minor, except there's a couple of things that 403B plans do that 401K plans are not required. One is it must be invested in a mutual fund company or a life insurance. And then also a 403B allows for greater annual deferrals after you have about 15 years of service with the organization. This is a pretty technical area. And some of the other things that 403B plans do is it allows for greater annual deferrals after you have about 15 years of service with the organization. Other common retirement vehicles are still available to pastors.

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And so one of those, again, is an individual retirement account, an IRA. And these can really be pre-tax or after-tax, depending on your income level. A pre-tax IRA would give you an immediate current year tax deduction, and it would grow tax-deferred, but then be subject to ordinary income tax when you withdraw it. Now, there's another vehicle called Roth IRAs, which are considered after-tax contributions.

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They can still grow tax-free, and then when they're distributed, you don't pay any kind of income tax on the income when you distribute them. So it's a really nice benefit for that. As it relates to insurance, you know, the key to any kind of insurance is to transfer the risk of loss to another party. Primarily because we do

not... have the resources financially to afford any form of tragedy that might occur.

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These insurances include health, disability, life, long-term care, auto, homeowners, renters type insurance. With health insurance, typically traditional health insurance plans are offered through your employer, either on a fully contributed employee benefit basis or where the employee pays and partially contributes towards the employee benefit. HMOs are a common type that you see in these group benefit plans because they're generally.

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less expensive than the alternative, which is a personal choice plan. High deductible plans. Now, are also becoming very popular today and these plans really require a certain level of medical, to be paid first by the insured before the insurance company kicks in and paying things on your behalf. Now, where available, you know, it's really advantageous to consider utilizing what's.

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called a health savings account, an HSA, or a flexible spending account to pay for some of those like out-of-pocket medical, dental, vision costs with pre-tax dollars. Now, when I say pre-tax dollars, this is really where when you make that contribution to an HSA or a flexible spending account, you're getting a current tax deduction. And so when you spend $100 out of your HSA, because of the tax deduction, it's really.

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only requiring $75 worth of your money in order to pay, you know, that full $100. Disability insurance. This is another area that you want to consider. And, you know, you are much more likely to become disabled than to die prematurely. Now, generally, you can assess your risk level based upon your extracurricular activities. Think of, you know, injuries that people incur during employment are really covered through workers' compensation.

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that's paid for by your employer. But disability insurance really covers those things that happen outside of work. Now, disability insurance is usually purchased for either a short-term policy or a long-term policy. The short-term disability policy often pays about two-thirds or 67% of your regular pay up to a period of about six months.

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After the six-month period is over, over, a long-term policy will kick in, and the length that the long-term policy will pay is often subject to certain overall limits, and its criteria is based upon your income levels. Now, depending on who pays for this disability insurance coverage determines the taxability of the income received. If the disability insurance is paid for by your employer, the income is typically taxable.

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Now, if it's paid by you separately with after-tax dollars, the income is non-taxable. Another insurance to consider is long-term care insurance. This provides coverage for in-home care, assisted living in a community, or possibly in a nursing facility. So why would you buy long-term care insurance? It's really to help maintain options for yourself in selecting the type of care that you want.

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types, and places of care when you need it. It also protects your other assets and income from the additional annual costs related to health-related needs when you are older. And then if you have a family history of chronic illnesses, maybe such as arthritis, Alzheimer's disease, stroke, dementia, or Parkinson's, long-term care is important to consider. So why not to maybe consider long-term care insurance?

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The annual premium cost is pretty expensive. It's about 7% to 10% of your annual income. And maybe if you have limited assets to protect, there's just not a lot at risk for you. Now, it is a good idea to consider obtaining these policies during your pre-retirement years. You're much more likely to qualify for better rates, when you are younger and in better health. So what is a pre-retirement year?

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You know, maybe as you hit your 50s, that's when you want to start looking into long-term care insurance. Another type of insurance that we're familiar with is auto insurance. And there's two main coverages involved with auto insurance. Collision coverage. Now, that is to cover a repair to a damaged vehicle. This is the more expensive coverage, but the higher the deductible, the lower the actual cost of the insurance. Comprehensive is the other side to auto insurance, and this helps to cover things, a loss from theft or a non-collision type damage to the vehicle.

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Maybe if you broke your windshield or something like that. Life insurance. You know, the primary reasons for life insurance are really how I see it threefold. It's to provide income for the family due to a loss from an income earned. earner in the family. It can also provide income for a family to meet their final, you know, funeral and burial costs. And some people use life insurance as well to maybe leave.

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a legacy, whether it's for your family or possibly even for your church or other non-profit organizations. Now, the two types of life insurance are term and whole life. Now, term is your least expensive, and you can typically lock in your rates for like 10 to 30 years, and it's comparable to sort of like renting. You know, you rent an apartment, you pay your term insurance each and every year. Now, permanent or whole life insurance is a little more expensive, but it covers your.

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entire lifetime so long as the annual premiums are made. It builds up cash value, or think of it like equity in your home. And that cash value can, be used to pay future premiums or can be distributed out to you as part of your insurance proceeds. So what is the right amount of life insurance that you want to carry for yourself? It really is going to depend upon a lot of things as it relates to your personal finances.

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What is your annual income that must be replaced? What kinds of costs are necessary to be satisfied or replaced? Maybe you want to be able to cover the balance in your mortgage or cover a college funding requirement, or pay off some debts or funeral and burial costs. Last is estate planning. Now, we're not going to get into too many details around estate planning, but some of the basics that I think you want to need, that I want you to know about and think about today.

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are creating a will. Create a living will. This is really a health care directive that you have to help inform decisions related to your health. Create a durable power of attorney. This will authorize someone else who can actually speak and act in your best interest should you become incapacitated or unable to do that. So we've just hit on a number of key financial considerations.

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for both your church as well as for yourself personally. There's a lot to understand, so give yourself a little bit of grace and time to really truly comprehend what you need to understand with finances. This is complex stuff, and there's no expectation that you're going to know it all. But I would also appeal that you will be a better leader and a better pastor when you have a good understanding of what you're doing. of these important financial considerations.

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for your church as well as yourself. Now, go back to that list of questions that you may have jotted down and compiled that list of things and use that as an outline to consider your study and growth in the areas of finances for churches and for pastors.