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March 26, 2020

Board of Directors
Indiana Pork Producers Association, Inc.
Indianapolis, Indiana

Dear Members of the Board:

We have audited the financial statements of Indiana Pork Producers Association, Inc. (the Organization) for the year ended December 31, 2019, and have issued our report thereon dated as of the date of this letter.

This letter is not required by professional standards. However, we want to inform you about issues of importance to the not-for-profit (NFP) community in order to assist you in continuing to proactively plan for the future of the Organization. The purpose of this letter is to inform you about the status of certain emerging developments that will affect NFP organizations.

1. CHARITABLE GIVING PREDICTIONS FOR 2020 AND 2021

The annual Philanthropy Outlook researched and written by Indiana University Lilly Family School of Philanthropy and presented by Marts & Lundy in February 2020 provides a positive outlook about the charitable giving environment in 2020 and 2021.

Some of the more significant predictions in the report include:

- After a couple of transition years for giving due to the Tax Cuts and Jobs Act (TCJA) passed at the end of 2017 as well as other factors, estimates for 2020 and 2021 reflect a return to broad growth in charitable giving.
- Total giving is expected to increase by 4.8% in 2020 and by 5.1% in 2021. Total giving is expected to be higher than the historical 10-year, 25-year and 40-year annualized average rates of growth.
- Specific factors expected to significantly and positively influence total giving in 2020 and 2021 include:
 - Above-average growth in the S&P 500 in the preceding and projected years,
 - Growth in the preceding years' personal income, and
 - Growth in GDP
- Giving by American individuals/households is predicted to increase by 4.4% in 2020 and by 4.7% in 2021. Contributions from both itemizing and non-itemizing households are included.

- Giving by foundations is predicted to increase by 6.3% in 2020 and by 6.6% in 2021.
- Giving by estates is predicted to increase by 6.6% in 2020 and by 6.5% in 2021.
- Weak corporate giving is projected, with giving by corporations predicted to increase by only .4% in 2020 and by 1.4% in 2021.

This report presents a stress test using characteristics similar to the Great Recession of 2007-2009 to see how charitable giving would change compared with the predictions indicated above. Given the impact of the Great Recession on giving during 2008, it makes sense for NFPs and fundraisers to stress test their own organizations and look for ways to manage potential risk. Under similar assumptions anticipating a future recession to occur through 2020, this report indicates that total giving would be 10.6% lower than the current projections for growth in 2020.

Even with a more positive giving outlook, significant disrupters can emerge. Donor and funder engagement remains critical for all charities whether in good times or bad.

2. NOT-FOR-PROFIT TAX UPDATE

NFP organizations will continue to feel the impact of the changing tax landscape for some time. We believe two areas are of important note for the year ahead, the rise of donor advised funds and the Taxpayer Certainty and Disaster Relief Act of 2019, which brought changes for private foundations and a repeal of the parking tax.

Donor-Advised Funds

Donor-advised funds (DAFs) have experienced significant growth over the last ten years. According to the National Philanthropic Trust's 2019 Donor-Advised Fund Report, grantmaking from DAFs to qualified charities has nearly doubled in the past five years and totaled \$23 billion in 2018. Additionally, contributions into qualified DAFs exceeded \$37 billion for the same time period, representing an 86% increase in contributions to DAFs over the past five years.

What exactly is a DAF? DAFs are charitable sponsoring organizations in which the donor reasonably expects to maintain advisory privileges over the distribution of the assets contributed to the fund.

Why is this important now? While DAFs have been around for quite some time, the passing of the 2017 Tax Cuts and Jobs Act have (and the raising of the standard deduction) made them more attractive to certain donors since they provide donors the ability to "bunch" contributions. This means that instead of giving \$5,000 in charitable contributions one year and \$5,000 the next year, donors can contribute \$10,000 into a DAF this year and advise the DAF to payout in accordance with the original giving intent. Since contributions are deductible to the donor in the year the contribution is made to the DAF, the \$10,000 charitable deduction is immediately available to the donor regardless of when the funds are paid out of the DAF. This allows donors to effectively "bunch" contributions into a year they may be in a higher tax bracket or want to take advantage of itemizing deductions. DAFs also have the ability to receive appreciated securities as well as other noncash contributions that a donor may wish to

contribute, but the recipient organization may not be able to accept due to a gift acceptance policy or administrative burden.

Taxpayer Certainty and Disaster Relief Act of 2019

The Taxpayer Certainty and Disaster Relief Act (the Act) of 2019 brought several changes to the NFP sector. One particular change is to Section 4940 of the Internal Revenue Code which imposes a tax on the net investment income of private foundations. The Act changed the historic two-tiered tax system to a flat 1.39% tax on a private foundation's net investment income. Prior to the change, private foundations paid a 2% tax, which could be reduced to 1% if the foundation's distributions for the year exceeded the average payout rate of the past five years. This complicated calculation was not only an administrative burden, but had many private foundations avoiding larger payouts to other charitable organizations as to keep the preferred 1% tax bracket. With the change to the flat rate, we could see some private foundations paying out larger grants as the tax rate is no longer tied to the average payout rate.

The Act also passed the repeal of section 512(a)(7) as it pertains to NFPs. The "parking tax", which took payments made for qualified transportation fringes and converted it to "income" subject to the new 21% flat tax rate has been retroactively repealed to date of enactment.

3. CURRENT FRAUD TRENDS AFFECTING THE NOT-FOR-PROFIT SECTOR

With the continued rise in cybercrime, we are constantly bombarded with the latest news on cyberattacks and the latest hacker schemes and red flags to monitor. However, NFPs need to continue to focus on preventative and detective controls to mitigate fraud committed by individuals within or closely related to their organizations.

The Association of Certified Fraud Examiners (ACFE) issues an annual report on fraud statistics across global industries. The 2018 Global Report to the Nations on Occupational Fraud and Abuse reported several concerning trends:

Key findings

- Internal control weaknesses were responsible for nearly half of all frauds reported.
- Tips are still by far the most common initial detection method for fraud discoveries; employees provided over 50% of tips.
- Organizations with anonymous fraud hotlines detected fraud by tips more often than those without this option.
- Small businesses and organizations lost almost twice as much per incident (\$200,000 median loss for organizations with less than 100 employees compared with \$104,000 for those organizations with more than 100 employees).

Specifically for the not-for-profit sector

- It is estimated that 1 out of every 10 fraud losses occurs within an NFP organization.
- While the median loss for an NFP decreased to \$75,000 (down from \$100,000 in 2016), limited financial resources overall are impacted more significantly by fraud losses. Reputational risk associated with NFP fraud losses is also significant and difficult to measure.

Fraudster demographics

- Fraudster demographics have not changed significantly in the last several years. Most frauds are committed by males ages 31 to 45, and over 50% have an undergraduate college education or higher. Fraud losses caused by men were 75% higher than those caused by women.
- 52% of fraudsters had background checks performed, with only 10% revealing a red flag that was ultimately passed over by management.
- Fraudsters with longer tenure at their organizations stole twice as much; those with more than five years' experience noted a median fraud loss of \$200,000 (compared with a median loss of \$100,000 for those with less than 5 years' experience).

Behavioral red flags

- Interestingly, the following six behavioral red flags have been consistently rated as most common in every year of ACFE's fraud report since 2008:
 - Living beyond their means
 - Financial difficulties
 - Unusually close relationship with vendor/customer
 - Control issues, unwillingness to share duties
 - Divorce/family issues
 - "Wheeler-dealer" attitude

Most common occupational fraud schemes

- Billing schemes related to fictitious goods or services, inflated invoices or personal purchases.
- Corruption schemes where employees personally benefit from a business transaction (through bribery or undisclosed conflicts of interest).
- Expense reimbursement schemes related to fake or inflated business or personal expenses.
- Payroll schemes related to claims for false hours or ghost employees.
- Check and payment tampering schemes related to intercepting, forging, or altering checks or electronic payments.

Most effective anti-fraud controls

- Code of conduct and tone at the top
- Fraud hotline
- Fraud training for employees, with additional training for managers and executives
- Independent audit committee
- Anti-fraud policy
- Formal fraud risk assessments
- Surprise internal audits
- Job rotation / mandatory vacations

Administrators, board of directors, and management must be proactive in their approach to detecting and preventing fraud in their respective NFP organizations. An annual assessment of overall fraud risks related to specific operations and exposure, along with separate audit committee and/or board consideration of the assessment are critical process components as an organization considers internal controls. Considering the findings above and how those do or do not relate to your specific NFP organization can be a useful tool in determining what steps are most effective when addressing fraud.

4. HOW TO ASSESS YOUR INFORMATION TECHNOLOGY (IT) RISKS

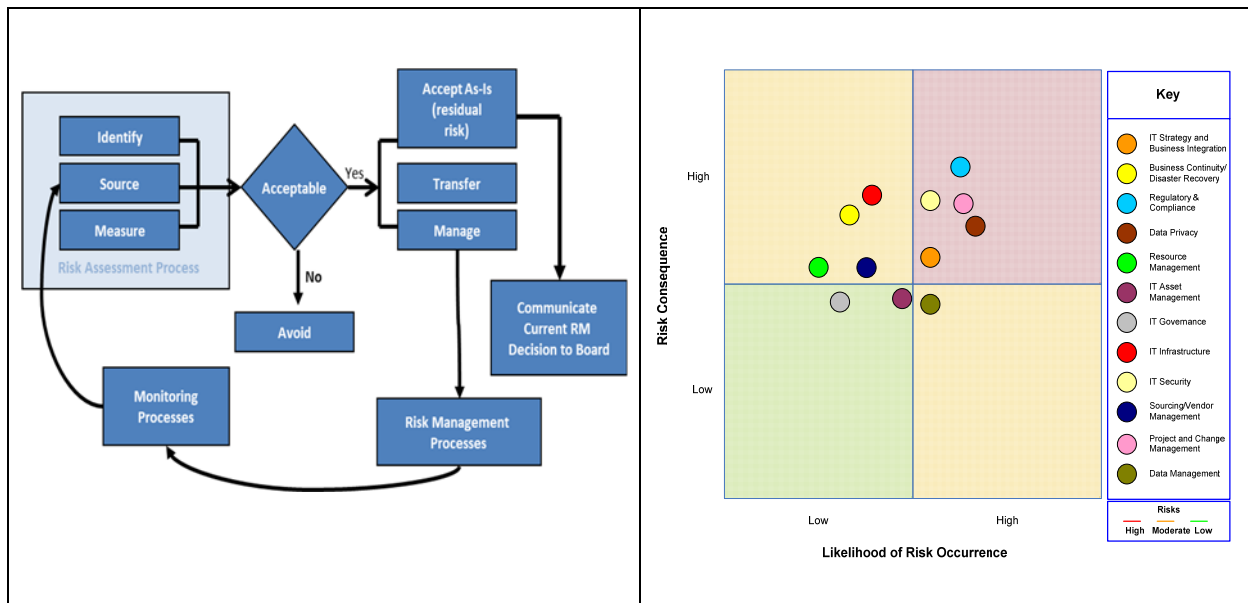
In our 2018 and 2019 current events update letters, we focused on cyber security including five basic practices to focus on in the 2018 letter, and the importance of recruiting board members with the technology and cyber security experience who can help you move the needle on security improvements in our 2019 letter. While both of these suggestions have not changed, this year we are encouraging NFP organizations to examine their overall IT risks to include, but go beyond, cyber security.

Most nonprofit boards simply don't understand IT and all the issues that go along with it, and they are unsure of their responsibility. That can make discussing IT risk issues intimidating when they surface and could create significant concern over legal liability. Managing IT risks, like any other risk, is a legal responsibility for all boards so NFPs should adopt a risk management system, develop risk management plans, and carefully monitor risks on a continual basis.

Creating a Risk Management System and Assessing Your Risks

In the beginning, the board or committee of the board should designate an individual or team that will take primary responsibility for assessing risks and implementing a formal risk management program that focuses on IT issues. Ideally, an NFP organization has a technology committee that includes subject matter experts in the areas of cyber security, IT operations, IT infrastructure, backup and recovery, licensing issues, cloud issues, and telecommunications. Augment these technologists with enterprise risk or internal audit leaders within companies and organizations in your city. Understanding IT risks requires nonprofit boards to be able to identify various types of risks and to know where they should be looking for them.

Once risks have been identified, they should be ranked on a low, medium, and high scale. These rankings should be across two dimensions. The first is the likelihood of the risk occurring and the second is the impact to the organization if the risk is realized. These risks can be communicated to the board in the example heat map below and allow the board and committees to understand the risk management processes in place.



Managing Risk

Once risks have been identified and rated, the next step is to understand how the risks can be managed down to an acceptable level. So many organizations use the term “mitigate” which is to infer you have made the risk go away. This is neither practical nor pragmatic in most cases. Most risks need to be accepted, but the impact and/or the likelihood of the risk must be reduced. For example, no matter what you do, you still have the risk of a cyber breach from a hacker, unless you disconnect all your systems from a network and never, ever, connect to the Internet. This is neither practical nor pragmatic but it would mitigate your risk. Rather, implementing various layers of defense, detection, and response should lower your risk of breach to an acceptable level.

We think of three ways to manage risks. First, accept the risk as is. Second, transfer the risk (outsource a key piece of technology, or insure the risk). Third, manage down to an acceptable level. Regarding insurance, there are a wide variety of policies that should be considered (e.g., business interruption insurance, cyber security/breach insurance) and having a commercial insurance professional on your board or IT committee can help navigate this confusing world.

Monitoring IT Risks

Nonprofit boards can monitor IT risks in several ways. Through an IT or risk committee, agendas can be formed around key risks, and key members of management or support staff can present at each committee meeting on a given topic (e.g., if you have personal health information and are a covered

entity under HIPAA rules – have the staff explain how they have met the HIPAA security requirements. Or, have the IT person explain how they perform data backups, test the backups, and how they would restore systems if there was an IT outage). This is where recruiting IT specialists to your board or committees of your board can be extremely valuable. Not only can they identify holes in the risk management system, they can offer cost effective and practical recommendation to help manage those risk down to an acceptable level.

Many NFPs look to an outsourced provider to assist them in the risk assessment process and to determine next steps. Our IT risk assessment team is available to help should you desire our assistance.

5. FASB ASU NO. 2016-02 – LEASES

Overview

During 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. This standard intends to improve financial reporting about leasing transactions by requiring entities that lease assets to recognize on their statement of financial position the assets and liabilities for the rights and obligations created by those leases, and to provide additional disclosures regarding the leases. The overarching goal is to regulate reporting practices so that financial statement users can more easily compare reports from different organizations.

Because of the significance of the changes required, the effective date of this standard was set several years in advance to give organizations proper time to consider the impacts and prepare for implementation. This standard is effective for public entities, including NFPs whose bonds are publicly traded for fiscal years beginning after December 15, 2018, which means calendar year 2019 and after. For all other entities, including all other NFPs, this standard was delayed one additional year and is effective for annual financial statements issued for fiscal years beginning after December 15, 2020, which means calendar year 2021 and after. If you have a fiscal year end, this would mean that the standard is first effective for your fiscal year ending in 2022. Early application of the standard is permitted.

Lessees (the party obtaining the right to use an asset) will likely see the most significant changes, although there are elements of the new standard that could impact almost all entities to some extent. The main difference from the previous guidance is that operating leases with contract periods greater than 12 months will now be recorded on the statement of financial position as *right-of-use assets* with offsetting *lease liabilities* based on the present value of future lease payments. Previously, only finance (formerly known as capital) leases were recognized on the statement of financial position.

Similar to previous guidance, the lessee will need to classify leases as either finance or operating to determine the proper accounting treatment. However, the explicit thresholds in the criteria under previous guidance have been removed. When a lease meets **any** of the following specified criteria at commencement, the lease should be classified by the lessee and lessor as a finance lease and a sales-type lease, respectively. Those criteria are below:

1. Transfers of ownership to lessee

2. Purchase option reasonably certain to be exercised
3. Lease term for major portion of asset's remaining economic life
4. Present value of lease payments and residual value exceeds substantially all of the fair value of the underlying asset
5. Specialized nature of underlying asset results in no expectation of alternative use after the lease term

If none of the above criteria are met, the lease should be classified as an operating lease for the lessee. The lease should also be classified as operating for the lessor, unless the lease meets both of the following criteria (in which case, the lessor would classify the lease as a direct financing lease):

1. The present value of the lease payments and any residual value guarantee that equals or exceeds substantially all of the fair value of the underlying asset, and
2. It is probable that the lessor will collect the lease payments plus any residual value guarantee

The expense recognition will not significantly change from the previous guidance. Operating leases will result in straight-line expense over the lease term, while finance leases will result in a front-loaded expense pattern (similar to interest expense on long-term debt).

For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election **not** to recognize lease assets and lease liabilities. In addition, there is a practical expedient that allows lessees to account for non-lease components (common area maintenance charges) with lease components.

While the recording of the assets and the liabilities for operating leases under the new guidance will primarily impact the statement of financial position, it will be important to consider whether these changes will impact contractual agreements and loan covenants, particularly those linked to specified debt to equity and debt service coverage ratios. Typically, these agreements are based upon the accounting rules in effect when the agreement was signed and may need to be adjusted to remain in compliance when the new guidance takes effect.

Other key differences in the new guidance center around the basic definition of a lease, the inclusion of *reasonably certain* to be exercised renewal options when measuring lease assets and lease liabilities, segregating lease and non-lease components, sale and leaseback transactions, and leases of specialized assets that will have no alternative use to the lessor (the party providing the right to use the asset) at lease conclusion.

Lessor accounting is largely unchanged from previous guidance and lessors will continue to classify leases as operating, direct financing, or sales-type. The vast majority of operating leases should remain classified as operating leases and permit lessors to generally recognize lease income on a straight-line basis over the lease term. Some changes have been made to lessor accounting to conform and align that guidance with the lessee guidance and with the new revenue recognition guidance issued in 2014.

NFPs that receive donated rent or have commitments for below-market leases should also consider the impacts of this new standard. Donated rent often means an NFP receives an unconditional promise to give the use of long-lived assets (such as a building or other facilities) for a specified number of periods in which the donor retains legal title; in this case the lease would have no lease payments. Since this standard defines leases as contracts that convey the right to control the use of identified property for a period of time in exchange for consideration, and there is no consideration exchanged, donated rent falls outside the scope of this standard.

NFPs that receive below-market leases (where lease agreements call for lease payments below the fair rental value of the property) also need to consider the impacts of the new lease standard. When calculating the right to use assets and lease liabilities, organizations should only include the actual lease payments made (and not the excess value of the fair rental value of the property). Any additional value (essentially, donated rent) would be recorded as a contribution. That contribution should be recorded at the fair value of the use (less any actual lease payments made) in the period in which the contribution is received and expense in the period the property or facilities are used.

Implementation Considerations

While ASU 2016-02 will likely have the greatest effect on organizations with large amounts of leased real estate or equipment, virtually all NFPs will also have to consider the impact of this standard on their leases of office space, equipment, and other items. Organizations should begin now with implementation considerations, including the following:

1. Analyze existing lease agreements individually for proper treatment under new guidance.
2. Evaluate the overall impact on your organization's financial statements as it relates to those existing leases.
3. Communicate with lenders and other parties with which the organization has contractual commitments to determine impact on existing or future covenants.
4. Educate management and board members on the impacts of this standard change.
5. Consider any future leasing commitments and the impact of the new standard on financial reporting for the organization.

This communication is intended solely for the information and use of management, the Board of Directors, and others within the Organization, and is not intended to be and should not be used by anyone other than those specified parties.

Board of Directors
Indiana Pork Producers Association, Inc.
March 26, 2020
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We appreciate this opportunity to be of service and extend our thanks to everyone at the Organization for their cooperation and assistance. We would be pleased to discuss any of the above matters with you at your convenience.

Very truly yours,

Blue & Co., LLC