BKD
CPAs & Advisors

200 E. Main Street, Suite 700 | Fort Wayne, IN 46802-1900
260.460.4000 | Fax 260.426.2235 | bkd.com

Board of Directors
Lutheran Social Services, Inc
Fort Wayne, Indiana

As part of our audit of the financial statements of Lutheran Social Services, Inc. (Organization) as of and for the year ended December 31, 2019, we wish to communicate the following to you.

AUDIT SCOPE AND RESULTS

Auditor's Responsibility Under Auditing Standards Generally Accepted in the United States of America

An audit performed in accordance with auditing standards generally accepted in the United States of America is designed to obtain reasonable, rather than absolute, assurance about the financial statements. In performing auditing procedures, we establish scopes of audit tests in relation to the financial statements taken as a whole. Our engagement does not include a detailed audit of every transaction. Our engagement letter more specifically describes our responsibilities.

These standards require communication of significant matters related to the financial statement audit that are relevant to the responsibilities of those charged with governance in overseeing the financial reporting process. Such matters are communicated in the remainder of this letter or have previously been communicated during other phases of the audit. The standards do not require the auditor to design procedures for the purpose of identifying other matters to be communicated with those charged with governance.

An audit of the financial statements does not relieve management or those charged with governance of their responsibilities. Our engagement letter more specifically describes your responsibilities.

Qualitative Aspects of Significant Accounting Policies and Practices

Significant Accounting Policies

The Organization's significant accounting policies are described in Note 1 of the audited financial statements. Management has the responsibility for the selection and use of appropriate accounting policies.

ASC 606, *Revenue from Contracts with Customers*

Effective January 1, 2019, the Organization adopted ASC 606, *Revenue from Contracts with Customers*, as further discussed in the Alternative Accounting Treatments section below. ASC 606 applies to all contracts with customers other than those within the scope of other standards, such as leases, insurance, financing arrangements, financial instruments and guarantees (other than product or service warranties).

The new revenue recognition standard eliminates the transaction- and industry-specific revenue recognition guidance under legacy generally accepted accounting principles (GAAP) and replaces it with a principle-based approach for determining revenue recognition. The core principle of the revenue recognition standard is that an entity should recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

In implementing ASC 606, the Organization was required to re-evaluate all contracts within the scope of the standard (other than those excluded under practical expedients elected) under a five-step model for revenue recognition. While certain entities were affected more than others, all entities are subject to extensive new disclosure requirements.

ASU 2018-08, *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*

Effective January 1, 2019, the Organization adopted ASU 2018-08, *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made.* ASU 2018-08 applies to all grants and contributions received and clarifies the accounting guidance applicable for grant accounting.

Historically, there was diversity in practice for accounting for grants. Some grantees considered grants to be an exchange transaction, whereas others reported grants as donor-restricted contributions. ASU 2018-08 provides guidance that unless the grantor is directly receiving value in the same amount as the services provided (an exchange transaction), the grant should be considered a contribution. In addition, if the grantor incorporates barriers into the contract and has a right of return, the transaction is considered to be a conditional contribution. Under the accounting guidance, conditional contributions are not recorded as revenue until the condition has been met.

In implementing ASU 2018-08, the Organization was required to evaluate all grant agreements. Adoption of the ASU may cause a change in the timing and classification of grant revenues.

Alternative Accounting Treatments

We had discussions with management regarding alternative accounting treatments within accounting principles generally accepted in the United States of America for policies and practices for material items, including recognition, measurement and disclosure considerations related to the accounting for specific transactions as well as general accounting policies, as follows:

- In connection with the adoption of ASC Topic 606, *Revenue from Contracts with Customers,* management has elected the use of the modified retrospective approach and elected to apply guidance to all contracts not completed at the date of initial adoption
- In connection with the adoption of ASU 2018-08, *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made,* management has elected an accounting policy that conditional contributions having donor stipulations, which are satisfied in the period the gift is received, are recorded as revenue with donor restrictions and then released from restriction.

Management Judgments and Accounting Estimates

Accounting estimates are an integral part of financial statement preparation by management, based on its judgments. The following areas involve significant estimates for which we are prepared to discuss management's estimation process and our procedures for testing the reasonableness of those estimates:

- The fair value of investments
- Allowance for uncollectible accounts and grants receivables based on analysis of payment history, current status, financial condition and anticipated economic conditions
- The estimated value of the beneficial interest in perpetual trust

Financial Statement Disclosures

The following areas involve particularly sensitive financial statement disclosures for which we are prepared to discuss the issues involved and related judgments made in formulating those disclosures:

- Valuation of investments
- Net assets
- Concentrations
- Liquidity and availability

Audit Adjustments

During the course of any audit, an auditor may propose adjustments to financial statement amounts. Management evaluates our proposals and records those adjustments which, in its judgment, are required to prevent the financial statements from being materially misstated.

There were no audit adjustments proposed as a result of the 2019 audit.

Auditor's Judgments About the Quality of the Organization's Accounting Principles

- The Organization adopted Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)* effective January 1, 2019, using a modified retrospective approach
- The Organization adopted the provisions of ASU 2018-08, *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made* effective January 1, 2019

All other accounting principles were consistent with prior years.

Disagreements With Management

Disagreements with management occasionally arise over the application of accounting principles, basis for estimates made by management, scope of the audit, disclosures to be made in the Organization's financial statements or wording of the auditor's report. We did not encounter any disagreements in these areas.

Difficulties Encountered in Performing the Audit

Our audit requires cooperative effort between management and the audit team. We would like to thank everyone at the Organization who was involved in the 2019 audit for their assistance and cooperation.

Other Material Communications

Listed below are other material communications between management and us related to the audit:

- Management representation letter (attached)

OTHER MATTER

We observed the following matter and offer these comments and suggestions with respect to the matter which came to our attention during the course of the audit of the financial statements. Our audit procedures are designed primarily to enable us to form an opinion on the financial statements and, therefore, may not bring to light all weaknesses in policies and procedures that may exist. However, this matter is offered as a constructive suggestion for the consideration of management as part of the ongoing process of modifying and improving financial and administrative practices and procedures. We can discuss this matter further at your convenience and may provide implementation assistance for changes or improvements.

FASB Issues New Lease Accounting Standard

On February 25, 2016, FASB issued Accounting Standards Update (ASU) 2016-02, *Leases (Topic 842)*, the long-awaited new standard on lease accounting.

Under the new ASU, lessees will recognize lease assets and liabilities on their balance sheet for all leases with terms of more than 12 months. The new lessee accounting model retains two types of leases and is consistent with the lessee accounting model under existing GAAP. One type of lease (finance leases) will be accounted for in substantially the same manner as capital leases are accounted for today. The other type of lease (operating leases) will be accounted for (both in the income statement and statement of cash flows) in a manner consistent with today's operating leases. Lessor accounting under the new standard is fundamentally consistent with existing GAAP.

Lessees and lessors would be required to provide additional qualitative and quantitative disclosures to help financial statement users assess the amount, timing, and uncertainty of cash flows arising from leases. These disclosures are intended to supplement the amounts recorded in the financial statements so that users can understand more about the nature of an organization’s leasing activities.

For all nonpublic entities, the final leases standard is currently effective for fiscal years beginning after December 15, 2019, and interim periods thereafter. Early application is permitted. A board decision was reached by the FASB at its April 8, 2020, meeting to delay the effective date of Topic 842 by one additional year for nonpublic entities (*i.e.*, fiscal year beginning after December 15, 2021). Issuance of a final ASU related to this decision is expected in May 2020.

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

BKD, LLP

Fort Wayne, Indiana
May 4, 2020

Lutheran Social Services, Inc.
333 East Lewis Street
Fort Wayne, Indiana 46802

May 4, 2020

BKD, LLP
Certified Public Accountants
200 East Main Street, Suite 700
Fort Wayne, Indiana 46802

We are providing this letter in connection with your audits of our financial statements as of and for the years ended December 31, 2019 and 2018. We confirm that we are responsible for the fair presentation of the financial statements in conformity with accounting principles generally accepted in the United States of America. We are also responsible for adopting sound accounting policies, establishing and maintaining effective internal control over financial reporting, operations and compliance, and preventing and detecting fraud.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, the following:

1. We have fulfilled our responsibilities, as set out in the terms of our engagement letter dated March 6, 2020, for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America.

2. We acknowledge our responsibility for the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

3. We acknowledge our responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud.

4. We acknowledge the Organization is not a conduit debt obligor whose debt securities are listed, quoted or traded on an exchange or an over-the-counter market. As a result, we acknowledge the Organization does not meet the definition of a "public entity" under generally accepted accounting principles for certain accounting standards.

5. We have reviewed and approved a draft of the financial statements and related notes referred to above, which you prepared in connection with your audit of our financial statements. We acknowledge that we are responsible for the fair presentation of the financial statements and related notes.

6. We have provided you with:

   (a) Access to all information of which we are aware that is relevant to the preparation and fair presentation of the financial statements such as records, documentation and other matters.

   (b) Additional information that you have requested from us for the purpose of the audit.

   (c) Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.

   (d) All minutes of directors' meetings held through the date of this letter.

   (e) All significant contracts and grants.

7. All transactions have been recorded in the accounting records and are reflected in the financial statements.

8. We have informed you of all current risks of a material amount that are not adequately prevented or detected by Organization procedures with respect to:

   (a) Misappropriation of assets.

   (b) Misrepresented or misstated assets, liabilities or net assets.

9. We understand the potential penalties for failure to disclose reportable tax transactions to the taxing authorities and have fully disclosed to BKD any and all known reportable tax transactions.

10. We have no knowledge of any known or suspected:

    (a) Fraudulent financial reporting or misappropriation of assets involving management or employees who have significant roles in internal control.

    (b) Fraudulent financial reporting or misappropriation of assets involving others that could have a material effect on the financial statements.

11. We have no knowledge of any allegations of fraud or suspected fraud affecting the Organization received in communications from employees, customers, regulators, suppliers or others.

12. We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.

13. We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware. Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with accounting principles generally accepted in the United States of America. We understand that the term related party refers to an affiliate; management, and members of their immediate families, subsidiaries accounted for by the equity method; and any other party with which the Organization may deal if the Organization can significantly influence, or be influenced by, the management or operating policies of the other. The term affiliate refers to a party that directly or indirectly controls, or is controlled by, or is under common control with, the Organization.

14. Except as reflected in the financial statements, there are no:

    (a) Plans or intentions that may materially affect carrying values or classifications of assets and liabilities.

    (b) Material transactions omitted or improperly recorded in the financial records.

    (c) Material gain/loss contingencies requiring accrual or disclosure, including those arising from environmental remediation obligations.

    (d) Events occurring subsequent to the statement of financial position date through the date of this letter requiring adjustment or disclosure in the financial statements.

    (e) Agreements to purchase assets previously sold.

    (f) Restrictions on cash balances or compensating balance agreements.

    (g) Guarantees, whether written or oral, under which the Organization is contingently liable.

15. We have disclosed to you all known instances of noncompliance or suspected noncompliance with laws and regulations whose effects should be considered when preparing financial statements.

16. We have no reason to believe the Organization owes any penalties or payments under the Employer Shared Responsibility Provisions of the Patient Protection and Affordable Care Act nor have we received any correspondence from the IRS or other agencies indicating such payments may be due.

17. We are not aware of any pending or threatened litigation or claims whose effects should be considered when preparing the financial statements. We have not sought or received attorney's services related to pending or threatened litigation or claims during or subsequent to the audit period. Also, we are not aware of any litigation or claims, pending or threatened, for which legal counsel should be sought.

18. Adequate provisions and allowances have been accrued for any material losses from:

    (a) Uncollectible receivables, including pledges.

    (b) Purchase commitments in excess of normal requirements or above prevailing market prices.

19. Except as disclosed in the financial statements, the Organization has:

    (a) Satisfactory title to all recorded assets, and they are not subject to any liens, pledges or other encumbrances.

    (b) Complied with all aspects of contractual and grant agreements, for which noncompliance would materially affect financial statements.

20. The financial statements disclose all significant estimates and material concentrations known to us. Significant estimates are estimates at the statement of financial position date which could change materially within the next year. Concentrations refer to volumes of business, revenues, available sources of supply, or markets for which events <u>could</u> occur which would significantly disrupt normal finances within the next year. Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable.

21. The fair values of financial and nonfinancial assets and liabilities, if any, recognized in the financial statements or disclosed in the notes thereto are reasonable estimates based on the methods and assumptions used. The methods and significant assumptions used result in measurements of fair value appropriate for financial statement recognition and disclosure purposes and have been applied consistently from period to period, taking into account any changes in circumstances. The significant assumptions appropriately reflect market participant assumptions.

22. We have not been designated as a potentially responsible party (PRP or equivalent status) by the Environmental Protection Agency (EPA) or other cognizant regulatory agency with authority to enforce environmental laws and regulations.

23. With respect to any nonattest services you have provided us during the year, including assisting with the preparation of the financial statements:

    (a) We have designated a qualified management-level individual to be responsible and accountable for overseeing the nonattest services.

(b) We have established and monitored the performance of the nonattest services to ensure that they meet our objectives.

(c) We have made any and all decisions involving management functions with respect to the nonattest services and accept full responsibility for such decisions.

(d) We have evaluated the adequacy of the services performed and any findings that resulted.

24. We are an organization exempt from income tax under Section 501(c) of the Internal Revenue Code and a similar provision of state law and, except as disclosed in the financial statements, there are no activities that would jeopardize our tax-exempt status or subject us to income tax on unrelated business income or excise tax on prohibited transactions and events.

25. We have identified to you any activities conducted having both fund raising and program or management and general components (joint activities) and have allocated the costs of any joint activities in accordance with the provisions of FASB ASC 958-720-45.

26. In connection with the adoption of ASC Topic 606, *Revenue from Contracts with Customer*, we represent the following:

(a) We have adopted ASC Topic 606, *Revenue from Contracts with Customers*, using the modified retrospective approach and elected to apply guidance to all contracts not completed at the date of initial application.

(b) We have identified portfolios to evaluate revenue recognition. Actual results under the portfolio approach are materially similar to evaluations on an individual contract basis.

(c) We have adequate controls in place to prevent and/or detect errors in revenue recognition measurement and disclosure on a recurring basis.

(d) The footnotes to the financial statements appropriately describe the adoption of ASC Topic 606, *Revenue from Contracts with Customers*, and include all additional disclosures required under the standard.

27. In connection with the adoption of ASU 2018-08, *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*, management has elected an accounting policy to record conditional contributions having donor stipulations which are satisfied in the period the gift is received are reported as revenue with donor restrictions and then released from restriction.

28. We have evaluated whether there are conditions or events known or reasonably knowable, considered in the aggregate, that raise substantial doubt about the Organization's ability to continue as a going concern within one year of the date of this letter without consideration of potential mitigating effects of management's plans not yet fully implemented and concluded substantial doubt does not exist.

29. We acknowledge the current economic volatility presents difficult circumstances and challenges for not-for-profit organizations. Not-for-profit organizations are facing declines in the fair values of investments and other assets, declines in contributions, constraints on liquidity and difficulty obtaining financing. We understand the values of the assets and liabilities recorded in the financial statements could change rapidly, resulting in material future adjustments to asset values, allowances for contributions receivable, etc. that could negatively impact the Organization's ability to meet debt covenants or maintain sufficient liquidity. We acknowledge that you have no responsibility for future changes caused by the current economic environment and the resulting impact on the Organization's financial statements. Further, management and the Board are solely responsible for all aspects of managing the Organization, including questioning the quality and valuation of investments and other assets, reviewing allowances for uncollectible amounts and evaluating capital needs and liquidity plans.

Angie Moellering, Chief Executive Officer

Shawna Squibb, Chief Financial Officer