November 21, 2019

Sent Via Email
Harvest Bible Chapel – Board of Elders
c/o Elder Board Chair Brian Laird

RE: Harvest Bible Chapel – Legal Evaluation Report

Dear Board of Elders:

I am writing to provide a summary of my law firm's prior legal evaluation and related forensic accounting information to Harvest Bible Chapel's (HBC) leadership in the aftermath of its former Senior Pastor James MacDonald's (MacDonald) departure.

I. Introduction

Based on our law firm's review of available information, we determined that a massive corporate governance failure apparently developed over several years at HBC, primarily due to the following factors:

- MacDonald's powerful and subversive leadership style;
- His development of an inner-circle leadership group through which he could control HBC;
- His marginalization of broader leadership, particularly the former HBC Elders; and
- His other aggressive tactics that thwarted healthy nonprofit governance.

Directly resulting from such problems, MacDonald appears to have extensively misused HBC's financial resources for improper financial benefit.

In conjunction with our law firm's legal evaluation, a forensic accounting evaluation was carried out and likewise focused on MacDonald. Included are relevant key findings from the accounting firm of Schechter Dokken Kanter (SDK). Both SDK and our law firm were professionally retained and directed to evaluate the corporate, employment, financial, and other information and to draw independent conclusions. SDK's credentials are available online at https://www.sdkcpa.com/. Our law firm's credentials are available at https://wagenmakerlaw.com/.

II. Factual Background

A. HBC Governance

Our law firm's legal evaluation contains an extensive description of HBC's historical development, multi-entity corporate structure (including various corporate iterations of

"Walk in the Word"),[1] church bylaw evolution, related governance changes, leadership trends, MacDonald's own leadership development, his marginalization of other leaders, the Executive Committee's development, Harvest Bible Fellowship's separation from HBC resulting from MacDonald's unilateral actions, the staff-oriented XLT's development, a deficient conflict of interest policy, MacDonald's pattern of aggressive and adversarial tactics against church leaders who opposed him, his sabbatical and then employment termination, and extensive related financial information, all based on information provided to our law firm.

MacDonald's strong and persuasive role as authoritative senior pastor, along with his close inner circle, insulation from proper accountability mechanisms, and key changes to the church's operational structures, resulted in a highly problematic culture. Policies, formal and informal, were put into place to reinforce this unhealthy power structure. HBC leadership's flawed "consensus" approach also contributed significantly to such problems, allowing MacDonald's strong and strident voice to inordinately influence others, since no bright-line standard existed to indicate adoption of a policy or assent to an action as would be present in a structured vote. Over time, such approach led to systemic failure.

B. HBC Finances

Such failure is perhaps most glaring in terms of HBC's finances, with shifted control to MacDonald and other executive staff, diminished board involvement, and too much discretion within MacDonald's inner circle. Lack of oversight problems and related financial control issues existed as well with HBC's internal ministries, most notably Walk in the Word Ministries (WITW) and Harvest Bible Fellowship (HBF).

Since WITW was treated as a separate ministry—and of MacDonald, not of HBC—the Elder Board persistently treated its assets separately from the church's assets. However, WITW was a fully integrated ministry of the church, and actually was the church operating under an assumed name. HBC not only fully controlled and owned WITW, it was the same corporate entity.

Additionally, per available HBC corporate minutes, when MacDonald ended HBC's relationship with HBF, the Elders authorized a "loan from WITW" in the amount of $1,500,000 to HBC. In doing so, the Elder Board reallocated its own funds, but given the confusion concerning ownership and legal status of WITW, the loan made it appear as though the Church was incurring a large debt to "James' ministry." Then, on November 9, 2017, the Finance Committee reported that WITW "is reducing loan balance by $1 million as a gift to HBC. Committee and staff expressed gratitude to WITW for this gift." This

[1] More specifically, they are as follows: (1) "Harvest Bible Chapel," which currently holds the assumed name (i.e., nickname) on "Walk in the Word Ministries," which has long carried out the ministry activities; (2) "Walk in the Word," which has long had relatively low assets; and (3) "Walk in the Word with Dr. James MacDonald," which was incorporated in March 2019.

“unconditional gift” from the church back to itself was treated as a gracious gesture, as if two separate entities had come to a well-intentioned understanding, when in fact the payment was merely a moving of the Church’s money from one of its accounts to another.

HBC also apparently maintained two bank checking accounts as follows: (1) “executive account”; and (2) “WITW reserve account.” The HBC accounting staff members were not privy to either account’s operations. The accounts were apparently controlled indirectly by MacDonald and directly by HBC’s former CFO, COO, and an executive assistant. The “executive account” was apparently used for deferred compensation contributions primarily for MacDonald, as well as for some of his personal expenses. The “WITW reserve account” was apparently used by MacDonald for personal clothing, hunting, and vehicles. Per our interviews with HBC accounting personnel, MacDonald’s usage of this WITW reserve account was consistent with his view that WITW Ministries was essentially his own business.

Another checking account and related credit card apparently existed in the name of “Vanilla Bean, LLC,” with MacDonald as the sole owner. This account and card were apparently used to confidentially manage his personal expenses. Such information raises concerns with respect to specific expenses that may have been paid by HBC and attributable as taxable income to MacDonald, as well as broader concerns about MacDonald’s financial improprieties involving his inner circle of leadership and secretiveness.

We understand that significant changes have now been made to end such secretive and highly improper financial management of HBC assets, which we commend.

C. MacDonald’s Executive Compensation

We were provided with extensive salary information for MacDonald and the HBC Compensation Committee’s year-end meeting minutes, reflecting summary approval for executive compensation, housing, deferred compensation, and the housing allowance for MacDonald. The Committee unanimously approved an overall 2015 compensation amount of $1,240,000, a 2016 compensation amount of $1,370,000, and a 2017 compensation amount of $1,387,500. For year-end 2017, we provided with a “Memorandum of Understanding and Documentation” dated December 19, 2017, reciting “commitments and pledges given in good faith [that] represent a contractual and covenant commitment” to MacDonald, plus a statement that “Walk in the Word and the respective assets are a bible teaching ministry of Dr. MacDonald.” For year-end 2018, the minutes of the “Elder Executive Committee Compensation Committee,” reflecting a total compensation package of $1,270,000 for 2019. MacDonald’s approved compensation consisted of a combination of salary from HBC, payment from WITW Ministries (even though it was an internal HBC ministry), “Family Travel” bonus, deferred compensation, other retirement benefits, health insurance, an annual “Teacher License Agreement” payment (apparently for intellectual property), an annual “STIP” performance bonus (“short-term incentive program” perk, based on general revenues, attendance, and major gifts), and discretionary bonuses.

HBC's "Covenant of Commitments" dated January 1, 2015 sets forth helpful aspirational statements. For example, Item Number 6 provides as follows: "as our founding pastor and primary leader, MacDonald's compensation will be determined annually by the Elder Executive Committee using best practices for independence." In addition, Item Number 8 states: "8. That while serving as the church's primary leader, MacDonald will invoke and involve the Elder Executive Committee in matters of governance and oversight so as to foster a culture of transparency, organizational excellence, and mutual accountability." Despite such statements, it seems questionable whether MacDonald's compensation was appropriately set.

Further, the procedures used lacked the requisite independence, evidence of appropriate due diligence, transparency regarding pastoral compensation determinations, sufficiently high quality of compensation evaluation, and any accompanying minutes or report reflecting such required information. Our law firm reviewed other materials upon which we understand HBC relied for its compensation determinations. We find such materials to be of dubious reliability as a sound basis for proper determination of MacDonald's executive compensation. For example, the Winters & King law firm provided a "Compensation Evaluation Study" ("Study") dated December 17, 2015, for HBC as its client (rather than independently done), relying on data gathered through circular methodologies internal to the law firm's business practices, and developed from the firm's own clients for which it presumably provided similar executive compensation studies to justify each other's organizations.

D. Alleged Financial Expense Improprieties Involving MacDonald

Numerous allegations of serious and extensive financial expense improprieties have been made against MacDonald and others, involving expenditures made by him and in connection with his pastoral and personal activities. Such matters have been addressed at length through the SDK forensic accounting, and SDK's summary findings are provided separately.

E. Intellectual Property

We were not provided with any HBC policy regarding ownership and usage of creative works produced by HBC, WITW, or other HBC-related ministry staff, including MacDonald. The only pertinent document is a signed document entitled "Covenant of Commitments" dated January 1, 2015, which addresses intellectual property matters as follows, and as between the HBC Elder Executive Committee and MacDonald. Per item no. 3, "all works of authorship created by MacDonald shall be his own and shall be shared with the church and any other parties as he deems appropriate." In addition, per item no. 4:

> *[A]lthough organizationally structured within the church as an internal ministry, Walk in the Word Ministries was founded by MacDonald, and are [sic] being used to support the broader vision for the church. Elder Executive Committee covenants that Walk in the Word Ministries will receive annual financial support from the church of no less than 5% of the church's general operating budget*

for that year. Elder Executive Committee covenants that at any time and at his choosing, MacDonald may cause Walk in the Word Ministries to become separated from the church, and all net financial and legal assets related to Walk in the Word Ministries would be released to MacDonald by the church. Further, should MacDonald cease his role as Senior Pastor, financial support from the church to Walk in the Word Ministries would cease.

We likewise were not provided with any corporate board minutes or other information reflecting proper due diligence regarding these intellectual property matters or other evaluation in HBC's best interests. Nor have we been provided with any corporate documentation or other information reflecting whether MacDonald recused himself from deliberations and votes on matters addressed in this "Covenant of Commitment" document. This arrangement is otherwise problematic as explained below, since it provides for HBC's relinquishment of its own charitable assets and for which MacDonald was already compensated as part of his pastoral duties.

III. Legal Aspects

Based on the foregoing factual background, our law firm identified several areas of applicable legal principles and concerns. In very brief summary, HBC's historical governance structure allowed for a small cadre of high-level leaders to run HBC. With MacDonald's reportedly strong and subversive leadership and other factors, it is not surprising that he could take advantage of HBC financially and otherwise. Several aspects of HBC's governance operations were extremely problematic, include governance overall, bylaws, committee usage, conflicts of interest, financial controls, employment compensation, employment tax matters, intellectual property, and ministry resource usage.

A. MacDonald's Conflict of Interest and Related Governance Issues

As a church leader, MacDonald owed significant fiduciary duties to HBC including a duty of loyalty, to maintain the HBC's interest as paramount over any conflicting personal interests. Such responsibility is grounded in a nonprofit governing leader's legal obligation to take care of the organization's well-being in furtherance of its religious tax-exempt purposes. This responsibility is also consistent with Biblical standards of integrity and stewardship for church leaders. While such paradigm may carry some challenges within a ministry context with an inherent overlay of spiritual authority, it is nevertheless vitally important to both effective governance generally and legal compliance.

Within this context, a leader who receives a tangible personal benefit as a result of a decision affecting the church's operations or assets has an inherent conflict of interest that must be fully addressed through disinterested, independent leadership decision-making. Based on our legal evaluation, MacDonald seems to have acted in his own personal interests - reaping significant personal financial benefits, avoiding accountability to any governing board, and with heavy-fisted exclusionary leadership. His close inner circle of HBC leaders helped him to do so and without the important accountability measures needed for effective nonprofit ministry governance. Such actions are obvious and patent, such as through lack of appropriate financial controls over certain bank accounts, the removal of MacDonald from the conflict of interest policy's coverage, his spending, and the lack of proper executive compensation evaluations.

We understand that the new HBC Elder Board has embraced governance principles of proper independent judgment and active oversight, which is commendable. More specifically, and with HBC's troubled past in clear view, the new HBC Elder Board has further addressed governance matters through drastically improved corrective measures such as fuller engagement of each elder, better processes for conflict resolution, improved financial oversight, and other significant governance improvements. All such changes are essential for HBC's current and future vitality.

B. Federal Tax Issues

1. Inurement

Consistent with common law fiduciary responsibilities, relevant federal tax law similarly prohibits the abuse of charitable assets for improper private gain. Pursuant to Section 501(c)(3), HBC must operate "exclusively" for tax-exempt purposes for public benefit, with no "inurement." (Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii)). Section 501(c)(3) expressly requires that "no part of the net earnings of [the organization] inures to the benefit of any private . . . individual." Inurement applies to corporate insiders as "disqualified persons," which is a term defined in the Internal Revenue Code Section 4958(f)(1) as a person, with respect to any transaction, who is in a position to exercise substantial influence over the affairs of a tax-exempt organization – i.e., MacDonald. Private inurement includes transactions between the tax-exempt organization and one of its insiders that results in excessive economic benefits inuring, or flowing, from the organization to the insider.

A common example of private inurement, and one of highest relevance here is the payment of unreasonably high compensation to executive staff. Compensation will be deemed reasonable if: (i) it is negotiated at arm's length (i.e., by an independent board); (ii) the amount is reasonable in light of the responsibilities and activities performed; and (iii) it is not merely a device for distributing profits. (Rev. Rul. 69-383, 1969-2 C.B. 113). MacDonald's compensation does not appear to meet these criteria, particularly since insufficient comparable executive compensation study data was obtained and HBC's "profitability" (or at least its cash flow) seems to have been relevant to MacDonald's pay (as he requested in 2010 per the Winters & King Study's inclusion of HBC's profitability as a legitimate factor).

2. Excess Benefit Transactions

Inurement leads directly to the related tax concept of an "excess benefit transaction" (EBT). Internal Revenue Code Section 4958 defines EBT as "any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person, and the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing the benefit."

Since MacDonald is a disqualified person, the question arises of whether he received any benefits exceeding the value of his services provided – i.e. an EBT. If so, MacDonald owes repayment of such excess benefit. Such repayment obligations could include excess compensation paid as wages to him, expenditures made for himself or others that properly should have been counted as his wages, and the value of lavish (i.e., excess) gifts bestowed on others. The SDK forensic accounting report addresses such matters at length, particularly to assist HBC with potential recovery of misused charitable resources, with preliminary findings subject to further investigatory measures.[2]

3. Automatic Excess Benefit Transactions

Additionally, some financial transactions involving MacDonald could be deemed an "automatic" excess benefit transaction (AEBT), regardless of whether the transaction was reasonable or not. AEBTs arise either from (i) failing to meet certain written substantiation requirements under an accountable reimbursement plan, or (ii) failing to otherwise count as nontaxable employee fringe benefits.

First, an economic benefit paid to a disqualified person in exchange for services (*i.e.*, compensation) will be treated as an AEBT *unless* the organization clearly indicates its intent to treat such benefit as compensation when the benefit is paid - such as by "written contemporaneous substantiation" as taxable employee compensation. (Treas. Reg. § 53.4958-4(c)(1)) As identified in the SDK forensic accounting report, some of MacDonald's use of HBC funds thus may warrant treatment as AEBTs such as personal travel, unsubstantiated monthly credit card expenses, personal home expenses, personal use of HBC-provided vehicles, bank account expenses that he controlled, and expenditures debatably for ministry purposes (e.g., house security improvements, office remodeling, lavish gifts to HBC staff and donors, lavish travel with others, tickets to high-priced sporting events, Elgin studio space improvements, big-game hunting, clothing for ministry media events).

Second, to be treated as a nontaxable employee fringe benefit, and therefore not an AEBT, an employee benefit must be allowable as a business deduction. (See I.R.C. Sections

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[2] Notably, Internal Revenue Code Section 4958 imposes a tax on any disqualified person with respect to an excess benefit transaction that is equal to 25% of the excess benefit. For example, if MacDonald was paid $100,000 too much, then he could be required to pay back the $100,000 amount to HBC and pay a $25,000 IRS penalty. If the excess benefit is not timely corrected within the taxable period, an additional tax equal to 200% of the excess benefit will be imposed on the disqualified person. Using the same example, MacDonald thus could owe a $200,000 IRS penalty on top of the $100,000 repayment obligation and initial $25,000 IRS penalty.

132(a)(3), 132(d), and 162) as a "reasonable and ordinary business expense." In tax parlance, an "ordinary" business expense is one that is common in the relevant trade or business. A "necessary" business expense is one that is beneficial and appropriate in the relevant trade or business. Such ordinary and necessary business expenses are not to be included in an employee's gross income, if paid directly by the employer. Per Treasury Regulations Section 1.162-2, a business connection must exist for directly paid or reimbursed expenses, with an adequate accounting (i.e., within 60 days), and any excess funds returned within a reasonable period of time.

Many of MacDonald's expenditures do not seem to satisfy the required "ordinary and necessary" business expense requirements for exclusion from his taxable income. Such matters further raise questions regarding whether his total HBC compensation was "excessive" or not and therefore requires repayment of excessive amounts and warrants potential IRS liability for tax MacDonald. SDK's forensic accounting report addresses such considerations in more detail, and further forensic investigation may be appropriate.

MacDonald could argue that much of the travel, gifts, tickets, and other apparently lavish expenditures were commensurate with the context, such as to interact with high net-worth donors who gave substantial gifts as well as in connection with high profile media events. But it is not necessarily reasonable to expect that the IRS would accept and agree with such arguments. Nor it is otherwise necessarily reasonable for HBC to accept that such use of its charitable resources constitutes wise ministry stewardship, particularly against the backdrop of marginalized leadership, secretively maintained bank accounts, and clearly conflicted leadership controlling the funds at issue.

HBC's response now to these conclusions about inurement, EBTs, and AEBTs is appropriate and good. More specifically, HBC's new Elder leadership is diligently seeking to identify financial abuses and losses involving MacDonald, such as through the SDK forensic accounting, corrective steps, and efforts toward optimal legal compliance.

C. Intellectual Property Issues

Under US copyright law, copyrighted works owned by a Section 501(c)(3) organization constitute charitable assets that cannot be used to impermissibly benefit, directly or indirectly, a private individual. For MacDonald as a "disqualified person" per the Tax Code, HBC must receive consideration equal in value to the copyright interests provided to disqualified persons. Consequently, the fair market value of intellectual property rights (e.g., WITW, as an integrated program of HBC) granted to him should be factored into the reasonable compensation analysis.

The "Covenant of Commitments" does not list any specific copyrighted works nor attempt to quantify the fair market value of the copyright interests transferred to MacDonald. Anything MacDonald created while an employee of HBC would be transferred to MacDonald and MacDonald would have exclusive control to share with the church or other parties "as he deems appropriate." This arrangement is problematic under Section 501(c)(3), by providing MacDonald with the full ownership interest in HBC assets without any valuation, cap, or right to control the manner in which the assets are used. Per this arrangement, MacDonald received unfettered control and ownership of all copyrights to works he was paid to create as an employee of HBC, regardless of value, and could do whatever he wants with such rights.

Given applicable tax constraints, correction under Code Section 4958 from MacDonald could include return of all ownership interests back to HBC, an accounting for any revenues received by MacDonald for such intellectual property that should have gone to HBC instead, and a reporting of the transaction(s) to the IRS. **U**nder certain circumstances, HBC could lawfully transfer or license its copyright interests to MacDonald, such as for fair market value or such step contributes importantly to HBC's religious purposes and no impermissible private benefit results. However, HBC cannot lawfully transfer full ownership and unfettered control of an undefined amount of charitable assets to an insider without any documented indication that HBC will receive any consideration or other benefit in return.

IV. Recommendations

As set forth in our law firm's legal evaluation, we provided numerous recommendations for HBC's drastic corporate, financial, and employment-related improvements. It is our understanding that the new HBC Elder Board has fully engaged with implementing our recommendations, including a strong Elder Board that exercises responsible oversight, probing questions, accountability expected from all executive staff and other leaders, and healthier leadership engagement. HBC has commendably undertaken to develop such improved measures including new bylaws, better committee structure and operation, avoidance of leadership insularity, improved protocols for addressing conflicts of interest, and high-quality governance training.

In keeping with such measures, I understand that the HBC Elder Board is fully committed to the forensic accounting process, particularly regarding appropriate redress for MacDonald's abuse of HBC's charitable resources, potential further investigation, and an appropriate financial resolution. HBC has also implemented significantly improved accounting protocols and executive compensation measures to ensure that prior problems never occur again.

We affirm these corrective and improved governance measures, along with the Elder Board's continue accountability to HBC membership, mindful of each Elder's tremendous stewardship responsibilities. We deeply appreciate the opportunity to come alongside you and HBC in this tremendously pivotal juncture, for HBC's future and for the glory of God as paramount above all.

Sincerely,

Sally Wagenmaker

Enclosure: SDK Forensic Accounting Report Summary

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November 21, 2019

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Re: Harvest Bible Chapel

Dear Ms. Wagenmaker:

You asked Schechter Dokken Kanter ("SDK") to prepare a report summarizing the results of our forensic analysis of possible financial irregularities within Harvest Bible Chapel ("HBC"), focusing on transactions involving James MacDonald, HBC's former Senior Pastor. This report is a summary of our findings to date ("SDK Summary Report").

INTRODUCTION

We performed a forensic accounting investigation of certain transactions included in certain checking and credit card accounts that are defined as "Private Accounts" in the SDK Summary Report, for the purpose of locating and quantifying alleged financial irregularities. This SDK Summary Report was requested by the HBC Elder Board. Please note that this SDK Summary Report is preliminary in nature and is subject to supplementation to reflect additional forensic accounting procedures pursuant to the Elder Board's request. We do not assume responsibility for updating this SDK Summary Report for events or circumstances that may occur subsequent to the date of this SDK Summary Report.

We understand that this SDK Summary Report will be attached to your summary legal evaluation ("Summary Legal Evaluation"). Please note that this SDK Summary Report should only be read in conjunction with the Summary Legal Evaluation.

SCOPE

SDK approaches financial investigations in phases, with procedures to be performed during each phase based upon the exercise of our professional judgment. Through discussions with HBC's legal counsel and select members of the Elder Board, it was agreed that the first phase of our forensic accounting investigation would focus on applying procedures to transactions that occurred from January 2016 through February 2019 within two checking accounts (the "Private Checking Accounts") and one credit card account (the "Private Credit Card Account") that HBC separately maintained for the benefit of the Office of the Senior Pastor (collectively, the "Private Accounts").

The nature of the procedures was limited. The quality and availability of relevant records and the turnover of personnel within HBC also affected our procedures. Therefore, additional errors or irregularities may exist within HBC that we did not identify during the performance of these procedures. Since this SDK Summary Report is preliminary in nature, additional information may come to our attention that could affect this SDK Summary Report.

OVERVIEW OF FINDINGS

Based on our work to date, our preliminary findings are summarized as follows:

- From January 1, 2016 through February 14, 2019, approximately $3.1 million was spent through the Private Accounts, which were controlled by James MacDonald and his close associates. Those funds were spent as follows:
    - Approximately $1.2 million was used to fund deferred compensation plans, primarily for the benefit of James MacDonald, all of which was approved by HBC's compensation committee.

  - Approximately $1.9 million was used for other spending, apparently at James MacDonald's direction.

- The Private Accounts lacked financial controls as the disbursement procedures deviated from HBC's internal standard operating procedures. We noted the following deficiencies:
  - There was no independent oversight, which is consistent with the Summary Legal Evaluation's general finding that James MacDonald was continually able to avoid accountability.
  - Most expenditures lack supporting documentation adequate to determine who authorized the purchases and whether the expenditures served a purpose for HBC or were of a personal nature. The responsibility to substantiate expenses rested primarily with James MacDonald as the Senior Pastor and as the individual most involved with the spending through the Private Accounts.

- James MacDonald and his family members received direct payments from the Private Checking Accounts and benefitted from other payments made on their behalf for known personal expenditures, in the aggregate amount of $286,096 (which has been reduced for any known reimbursements from James MacDonald). The categories of such expenditures are as follows:
  - $142,058 was paid directly for James MacDonald's known personal expenses, of which $48,127 was added to his W-2 as additional compensation.
  - $23,378 was paid directly or indirectly to James MacDonald for reimbursements that do not establish a business connection and are not substantiated as required by the Internal Revenue Code [IRC Sec. 62(c) and Reg. 1.62-2(c)].
  - $120,660 was spent for the direct personal benefit of James MacDonald's family members.

- HBC incurred other expenses through the Private Accounts that benefited James MacDonald, however the extent of the personal benefit is inconclusive at this time. Examples of such categories of expenditures include the following:

  - $416,139 was spent on travel (including those expenses related to James MacDonald's "refreshment"),[1] of which $94,046 was added to his W-2s as additional compensation.
  - $170,851 was spent on hunting and fishing trips and related expenses. Expenses within this category include hunt cost, airfare, lodging, gas, food, gratuities, apparel, guns, and taxidermy (and related shipments).
  - $139,502 was spent on meals and entertainment. Entertainment expenses within this category include golf, club dues, boat tours, and event tickets.
  - $94,017 was spent on apparel and eyewear, of which $17,277 was added to James MacDonald's W-2s as additional compensation. It is our understanding that these purchases were not required as a condition of employment, therefore tax guidance states that the cost and maintenance of such expenditures represented personal expenses.

- HBC incurred other significant expenses through the Private Accounts. It is unclear whether such expenditures were ordinary and necessary expenses of HBC. Such categories of expenditures include the following:
  - $247,858 for gifts/donations/"blessings"/benevolence
  - $71,750 for deer farm expenses
  - $114,159 for "refreshment" expenses for other members of the Senior Executive Leadership Team.

- HBC maintained a short-term incentive compensation plan (STIP) for members of the Executive Leadership Team (XLT). Members of the Senior XLT could earn additional compensation under the STIP through the achievement of certain metrics, including financial targets for surplus amounts and major gifts. James MacDonald received bonuses, apparently under the STIP, of $130,000 and $143,125 for 2016 and 2017, respectively.

[1] We understand "refreshment" expenses to generally mean personal travel necessary to rest, reflect and recharge to enable one to continue to serve effectively. This is a component of approved compensation for James MacDonald. "Refreshment" is not a tax or business term.

BACKGROUND[2]

Harvest Bible Chapel

HBC is a non-denominational Christian church with a focus centered on efforts that establish, strengthen, and reproduce biblically-based churches, which then plant churches that plant churches for future generations and God's glory.[3] HBC was launched in September 1988, in Rolling Meadows, Illinois, and has grown to include multiple campuses throughout the Chicago metropolitan area with attendance in the thousands.[4]

Pastor James MacDonald

James MacDonald ("MacDonald") was the first pastor appointed to lead HBC and had served as its Senior Pastor until his employment was terminated on February 12, 2019, "for engaging in conduct that the Elders believe is contrary and harmful to the best interests of the church."[5]

Walk In The Word

Walk In The Word ("WITW") was the broadcast ministry that MacDonald developed. We understand that WITW has been a fully integrated internal ministry program of HBC, fully controlled and owned by HBC, since at least 2012. Nonprofit entities exist with similar names, which has led to some confusion. We refer to WITW herein as an HBC internal ministry.

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[2] The information provided in this section has been intentionally abbreviated. A more comprehensive background is contained in the Legal Evaluation prepared by Wagenmaker & Oberly, LLC, dated May 31, 2019.
[3] https://www.harvestbiblechapel.org/what-we-believe/doctrinal-statement/
[4] https://www.harvestbiblechapel.org/our-story/
[5] https://www.harvestbiblechapel.org/2019/02/13/february-2019-elder-update-2/

Private Accounts

Since April 2014, HBC has maintained the Private Checking Accounts for the benefit of the Office of the Senior Pastor (OSP), ostensibly to allow for discretionary ministry spending and privacy regarding certain compensation components. The Private Checking Accounts were funded primarily through wire transfers from HBC's own operating accounts. Based on evidence seen to date, such accounts were intentionally kept beyond the control and oversight of HBC's governing board. HBC has utilized the Private Credit Card Account since October 2014. Payments applied to this account were made primarily from the Private Checking Accounts.

Predication[6]

During 2018, numerous reports were surfacing through news outlets and social media about alleged financial mismanagement at HBC. HBC's Elder Board reported on January 15, 2019, that MacDonald would be taking an indefinite sabbatical "as a result of the recent season surrounding the church" and would not be involved in the leadership decisions of the church during the sabbatical. HBC leadership subsequently received multiple letters raising issues about church finances.

HBC Procedures

HBC personnel discussed the issue internally and determined they would create detailed transaction registers for the each of the Private Checking Accounts and the Private Credit Card Account. We understand that HBC sought to capture as much available information on these registers as possible and also attempted to categorize each expenditure and who received any benefit. These registers were the starting point for our analysis of transactions.

[6] Predication is the basis upon which an examination is commenced. The investigation of alleged fraud, because it deals with the individual rights of others, must be conducted only with adequate cause or predication. The narrative provided in this section is not intended to be the totality of all circumstances warranting such an investigation.

SDK ANALYSIS

HBC Disbursement Procedures

We noted a contrast between the check disbursement process in the ordinary course of business and the process for the Private Checking Accounts. The "standard operating procedures" for the Private Checking Accounts circumvented the entire accounts payable department, excluded review by the director of accounting, and did not allow for appropriate general ledger coding. Our review of available archived emails appears to corroborate the weaknesses regarding the approval and recordkeeping of transactions within the Private Accounts.

MacDonald Compensation

We read and analyzed the available information to identify any written contemporaneous evidence regarding sources of authorized compensation. In each year the total reported for taxable compensation was significantly less than the total approved cash compensation, due in part to an annual housing allowance for a minister that could lawfully be excluded from gross wages for tax reporting.

There was a Short-Term Incentive Program available for members of the Executive Leadership Team (XLT). Schedules contained in the available archived emails indicate that the STIP for "Senior" XLT members was an incentive compensation plan based on the achievement of three metrics at HBC: (1) actual net surplus exceeds targeted net surplus, (2) actual attendance growth exceeds targeted attendance growth, and (3) actual major gifts exceed targeted major gifts. The current Elder Board has questioned whether the STIP (coupled with use of the Private Accounts) may have generated motivation to incur donor development expenses in hopes of reaping personal financial reward from the result of such efforts. We have not evaluated whether it was appropriate for MacDonald to have received a direct financial benefit from major gifts and net surplus amounts, but the Elder Board may wish to do so as he was a "disqualified person" for Internal Revenue Code purposes.

SDK FINDINGS

General

The operating checking accounts for HBC and WITW (albeit as an internal ministry program of HBC, and therefore technically belonging to HBC) provided substantially all of the funding of the Private Checking Accounts.

We identified $1,187,600 of deferred compensation plan contributions, most of which were for the benefit of MacDonald.

We then analyzed the spending in the Private Credit Card Account of approximately $900,000 and the Private Checking Accounts of approximately $1,000,000.

SDK followed certain tax guidance for purposes of our analysis of the spending in the Private Accounts. A church or religious organization is treated like any other employer as far as the tax rules on employee business expenses.[7]

Unsubstantiated Reimbursements to MacDonald

Our analysis revealed that HBC reimbursed MacDonald at least $23,378 for expenses without proper substantiation for those expenses.

Employer reimbursements of employee business expenses are subject to rules that distinguish between legitimate expense reimbursement arrangements and those that resemble additional compensation. HBC's internal policies regarding employee reimbursements stated that an accountable plan was being maintained. An accountable plan is a reimbursement or other expense allowance arrangement that requires employees to substantiate covered expenses and return unsubstantiated advances [IRC Sec. 62(c)].

[7] IRS Tax Publication 1828 (Rev. 8-2015).

The following requirements are applied on an employee-by-employee basis and must be met for such a plan to be accountable as required by the tax law [Reg. 1.62-2(c)]:

1. Proving a Business Connection. The plan pays reimbursements and allowances only for business expenses. The reimbursements and allowances must be clearly identified as such when the employee is paid.

2. Maintaining Adequate Substantiation. The plan requires substantiation of the reimbursed expenses. The employee accounts for the business expenses by submitting a detailed written record (such as an itemized receipt) substantiating the expense's time, place, amount, and business purpose within a reasonable period of time after the expenses are paid or incurred [Reg. 1.62-2(e)].

   If an employee pays or incurs business expenses and is reimbursed for those expenses by the organization without having "adequately accounted", the reimbursements are treated as made under a nonaccountable plan [Reg. 1.62-2(c)].

3. Requiring Employees to Return Excess Advances. The plan requires the employee to return any advance exceeding substantiated business expenses [Reg. 1.62-2(g)].

   Attempting to avoid returning the excess advance requirement by bonusing out excess advances to employees as salary rather than requiring the return of such amounts does not work. The regulations prohibit this and state all amounts paid under such a plan are treated as made under a nonaccountable plan [Reg. 1.62-2(j), Ex. (8)].

The aforementioned reimbursements to MacDonald in the amount of $23,378 fail to prove a business connection, are not adequately substantiated, and have not been returned to HBC. As such, the reimbursements are treated as having been made under a nonaccountable plan and should be regarded as taxable employee compensation.

Other Payments for the Direct Personal Benefit of MacDonald

Our analysis indicates that at least $142,058 was spent for MacDonald's personal expenses. Of this amount, only $48,127 was added to MacDonald's W-2s as additional compensation.

Expenditures for the Benefit of MacDonald's Family Members

Our analysis indicates that at least $120,660 was spent for the benefit of MacDonald's family members.

Travel

Our analysis indicates that at least $416,139 was spent on travel expenses for MacDonald and many others. Of this amount, only $94,046 was added to MacDonald's W-2s as compensation. Included in the air travel expenses above (and one flight in the hunting expense category that is described in a later section) is $152,364 of private aircraft. None of the private aircraft travel expenses were added to MacDonald's W-2 as additional compensation, and at least some of the travel appears to be related to HBC ministry activities. HBC's internal private aircraft policy states that only HBC's Executive Leadership Team are allowed to use private or chartered travel and that "a clear statement of the advancement of a Church ministry purpose must be included in the necessary paperwork filed to meet IRS regulation and requirements." We were provided a schedule named "Private Flight Tracking 2015-2018," which we understand was prepared by a former executive assistant, that includes the travel dates, destination(s), passengers, cost, and ministry purpose. Interviews with HBC personnel regarding the private flight activity and analysis of flight invoices revealed that the cost of the travel was often provided to HBC at a material discount.

Travel expenses are deductible only to the extent they are not lavish or extravagant under the circumstances [IRC Sec. 162(a)]. Certain courts have held that an expense must not only be ordinary and necessary, but that it must also be reasonable in amount and reasonable in relation to its purpose. A lack of supporting documentation has prevented us from evaluating travel expenses for reasonableness with regard to cost or ministry purpose.

An employee may incur expenses for travel, gifts, and use of a passenger auto or other listed property [as defined in IRC Sec. 280F(d)(4)] if they substantiate these expenses using the rules in IRC Sec. 274(d) and the underlying regulations [Reg. 1.62-2(e)(2)]. The employee must provide the following information regarding the expense [Temp. Reg. 1.274-5T(b)]:

1. The amount of the expense.
2. The time and place of the travel, the date and description of the gift, or the date of the expenditure or use with respect to the listed property.
3. The business purpose or benefit derived (or expected to be derived).
4. The employer's business relationship with the person(s) receiving the gift.

Employees must also submit documentary evidence to meet the adequate records requirement, such as a written receipt or a paid bill, for any lodging expense (regardless of amount) and for any other expense of $75 or more [Reg. 1.274-5(c)(2)]. The regulations do not specify the precise form of the documentary evidence.

Amounts paid or incurred with respect to a spouse, dependent, or other individual accompanying an officer or an employee on business travel generally are nondeductible unless [IRC Sec. 274(m)(3)]:

a. the accompanying individual is an employee,
b. the travel of the accompanying individual is for a bona fide business purpose, and
c. the travel expenses otherwise would be deductible by the accompanying individual.

Payments for Gifts/Donations/Blessing/Benevolence

Our analysis indicates that at least $247,858 was spent on payments noted as gifts, donations, "blessings," or benevolence. We understand that gifts, benevolence, and other payments can be part of the accomplishment of HBC's exempt purpose. However, such payments should be procured through the standard operating procedures, rather than at MacDonald's discretion through the Private Accounts. Moreover, we have reviewed HBC's formal benevolence policy that requires multiple steps before a case can be approved for spending in this category. Finally, certain of the expenditures in this category raise additional questions as to whether they were properly incurred for church operations.

Hunting Expenses

Our analysis indicates that at least $170,851 was spent on hunting and fishing trips and related expenses.[8] Expenses included in this category include hunt cost, airfare, lodging, gas, food, gratuities, apparel, guns, and taxidermy (and related shipments). The nature of these expenses and the fact that they were made from the Private Accounts raises the question of whether they were properly incurred for church operations.

Meals and Entertainment

Our analysis indicates that at least $139,502 was spent on meals and entertainment. Once again, a lack of supporting documentation for most transactions has prevented us from evaluating meals and entertainment expenses for reasonableness with regard to cost or ministry purpose. This lack of substantiation means that these expenditures cannot be deemed as "reasonable" within the meaning of applicable tax requirements.

[8] All expenses believed to relate to hunting trips have been classified as hunting expenses rather than in categories discussed elsewhere (e.g., travel, apparel, meals).

Apparel

Our analysis indicates that at least $94,017 was spent on apparel, including eyewear. Of this amount, only $17,277 was added to MacDonald's W-2s as additional compensation.

Work clothing and uniforms are only considered business expenses if both of the following tests are met:

1. The uniforms are specifically required as a condition of employment
2. The uniforms aren't of a type adaptable to general or continued usage to the extent they take the place of regular clothing [Rev. Rul. 70-474, 1970-2 CB 34]

Through inquiry of HBC personnel, we understand that MacDonald was not required to wear particular types of clothing for his employment and that the purchased clothing was suitable for general or personal wear. As such, the cost and maintenance of such clothing represent personal expenses attributable to MacDonald. We understand that MacDonald often gave gifts of apparel to others, so it is unlikely that all purchases were for MacDonald's direct personal benefit; however, the lack of receipts or other supporting documentation currently prevents such a determination. All such expenses remain attributable to MacDonald without substantiation that such expenses were for legitimate ministry purposes.

Deer Farm Expenses

Our analysis indicates that at least $71,750 of church spending related to a deer facility for Camp Harvest in Newaygo, Michigan, that is owned and operated by HBC.

STATEMENT OF LIMITING CONDITIONS AND CONCLUSION

We reserve the right to update this SDK Summary Report based on future events and circumstances which may become known to us in connection with this matter, or for additional information that may be supplied to us by HBC.

The forgoing presents our summary findings to date.

Respectfully submitted,

Schechter Dokken Kanter
Andrews & Selcer Ltd.

Minneapolis, Minnesota
November 21, 2019