



TEXAS
METHODIST
FOUNDATION

June 19, 2003

UMIFA Drafting Committee
Prof. Susan N. Gary
University of Oregon School of Law
1515 Agate St.
Eugene, Ore. 97403

Re: FAS 124 and UMIFA

Dear Professor Gary,

I am writing this letter to encourage the UMIFA Drafting Committee to address the accounting treatment of restricted funds within the provisions of the Uniform Management of Institutional Funds Act. Rather than recite to you a theoretical argument against the application of FAS 124, I'd like to introduce you to Texas Methodist Foundation and explain the effect its application has had on us.

Texas Methodist Foundation

Texas Methodist Foundation is a Texas nonprofit corporation organized and operated exclusively for charitable, religious and educational purposes within the meaning of 501 (c)(3) of the Internal Revenue Code of 1986, as amended. More specifically, the Foundation, founded in 1938, is organized and operated to serve United Methodist churches and institutions in Texas.

Our purpose is to empower the Church in the achievement of her God-appointed mission through our core values of competency, integrity and servanthood. We provide services in the areas of planned giving, endowment, stewardship, grants, investments, loans and education. As of December 31, 2002 total assets under management of the Foundation stood at \$261.3 million. Texas Methodist Foundation remains the largest United Methodist Foundation in the country.

We maintain four primary investment funds for churches and institutions and one, the Individual Fund, for individuals. Two of the four primary funds are interest rate investments: the Short Term Fund and the Methodist Loan Fund; and the other two are

market based investments: the Fixed Income Fund and the Equity Fund. In spite of instability in the stock market during 2002, our Equity Fund continued to outperform the Standard & Poor's 500 Index as it has for each of the past seven years.

One of our areas of service is to receive and manage permanent, irrevocable endowment funds established with the Foundation for the benefit of United Methodist churches and institutions in Texas. Endowment funds held by the Foundation are typically created by individuals via inter vivos or testamentary transfers. Most of the endowment funds held by the Foundation are administered for specifically identified beneficiaries. The Foundation does administer some endowment funds, however, over which we hold a variance power as to the beneficiary(ies) and/or the amount of distribution.

Due to the stock market decline over the past several years, the Foundation has experienced losses in our endowment funds and under FAS 124 these losses must be reflected as a reduction in our unrestricted net assets. In 2001 the reduction equaled \$255,715 and in 2002 it was \$771,180 amounting to a total reduction to our Capital Account of \$1,0226,895 over the past two years.

The reflection of this accounting loss on our balance sheet is highly problematic as we consider how it will be interpreted by our creditors, investors and donors and how we can minimize the effect while also meeting our fiduciary responsibilities.

Discussion of FAS 124

FAS 124, enacted in 1995, establishes standards for reporting gains and losses on endowment fund investments. It requires that endowment fund investments be recorded at fair market value each year and that unrealized gains be allocated to unrestricted net assets or temporarily restricted net assets depending on the fund. Unless the gift instrument or state law provide otherwise, endowment fund losses first reduce temporarily restricted net assets and then unrestricted net assets. This reduction must be reflected even if the endowment fund has fallen below historic dollar value. Thus, when an endowment fund's value is below historic dollar value as the Foundation's has been for the past several years, our unrestricted net assets are artificially deflated by this accounting standard.

While the intent of the accounting standard is to improve consistency among various institutions' financial statements, its application has caused some real concerns for the Foundation. Our Capital Account supports our risk assets, insulates investors of the Foundation from potential loss, provides a source of income for the Foundation to use at its discretion, promotes investor confidence, and allows the Foundation financial flexibility of expanding into new service areas. When the account is artificially deflated, a large number of the service areas of the Foundation are affected.

1. Our Capital Adequacy Policy limits the amount of loans we can have to a factor of our capital. Last year we had more than \$220 million in church loans, an increase of 19% from the previous year. A significant portion of our

operating budget is funded by loans. A reduction in the Capital Account reduces the amount of loans we can make.

2. The covenants we have with our bank set forth specific ratios and balances that must be maintained. In 2002, only a minimal growth in capital is reflected on our financial statement while in actuality we had over \$1 million of growth in our capital funds. A reduction in our Capital Account provides a potential misunderstanding as to the strength of our financials.
3. We have \$206 million invested with us by United Methodist churches, institutions and individuals across the State of Texas. We have \$9.6 million in gift annuity and other life income funds. We are managing \$8.9 million in endowment funds in which we have variance power, and \$9.1 million without variance power. Because we are not insured by the FDIC, all of our investors are relying on the history, staff, board, stability and growth of the Foundation when they place their funds with us. An inaccurate reflection of capital misrepresents to our constituents the true financial strength of the Foundation.
4. Last year we funded grants totaling \$494,878 benefiting various human service projects such as community outreach centers, childcare programs and assistance to the homeless. These grants are made possible primarily by gifts to the Foundation. We also have a new clergy leadership program funded in part by gifts to the Foundation. A major factor in our donors' willingness to give to our programs is our financial strength and growth. A falsely deflated capital account can negatively influence a donor's decision to give.

When our financial statement shows a loss or minimal increase to our capital assets, creditors, investors and donors alike are alarmed. Very few of them will take the time to read a footnote or listen to a lengthy explanation about accounting standards and how they don't change the legal nature of an asset. This is especially true in the wake of the fall of the Arizona Baptist Foundation and Enron.

Investment Decisions

We have a clear responsibility to protect the assets of the Foundation in order to provide a secure environment and withstand potential adverse effects of a changing economy. One way to minimize the type of loss to our Capital Account caused by the application of FAS 124 is to change the investment mix for the endowment funds that fall under its purview. By investing these funds in low risk securities, we can protect them against falling below historic dollar value. However, this will also limit their long-term growth.

In addition, under FAS 136 endowment funds over which the Foundation has no variance power are not subject to FAS 124. There is no mysterious policy reason behind this rule. It is simply the result of the fact that the Foundation serves as a conduit for endowment funds over which it holds no variance power but is more involved in the administration of endowment funds over which it does hold a variance power. Thus, we are faced with the possibility of having some of our endowment funds invested for long-term growth and some focused in low risk securities.

However, if we invest endowment funds so as to protect the Capital Account, we are ignoring UMIFA's requirement to invest for long-term growth while preserving the ability to make short-term distributions. Thus, following FAS 124 requires us to choose between our fiduciary responsibility to our donors and investors to protect the financial health of the Foundation and subjecting ourselves to the scrutiny of the Texas Attorney General's Office with respect to our investment policies under TUMIFA. We are presented with a situation in which there are no satisfactory alternatives.

Solution

We are asking you to consider the application of FAS 124 as it pertains to endowment funds under the provisions UMIFA and amend the statute so that the negative effects of the accounting standard outlined above are corrected.

FAS 124 provides in part, "in the absence of donor stipulations or *law to the contrary* [emphasis provided], losses on the investments of a donor-restricted endowment fund shall reduce ... unrestricted net assets" (paragraph 12). If a provision is added to UMIFA stating that any losses to an endowment fund are to be applied against the value of the fund and not against net unrestricted assets, these problems will be solved.

Thank you in advance for your consideration. If we can answer any questions or provide further information, please do not hesitate to call.

Yours truly,

A handwritten signature in cursive script, reading "Kathryn T. Longley".

Kathryn T. Longley
General Counsel