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November 3, 2005

CONFIDENTIAL

The Audit Committee of the
Board of Trustees
Unitarian Universalist Association:

Dear Members:

We have audited the financial statements of Unitarian Universalist Association (the "Association") as of and for the year ended June 30, 2005, and have issued our report thereon dated November 3, 2005. In planning and performing our audit of the financial statements of the Association, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements, and not to provide assurance on the internal control structure. We have not extended our audit procedures past our report date.

A material weakness is a condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be material weaknesses under the standards established by the American Institute of Certified Public Accountants. However, we noted no matters involving the internal control structure and its operation that we consider to be a material weakness as defined above.

The following observations and recommendations, all of which have been discussed with the appropriate members of management, are intended to assist management in formulating and enhancing operations of the Association while ensuring that the internal control structure remains effective.



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GOVERNANCE AND ACCOUNTABILITY

Boards and managers at all types of institutions continue to be scrutinized concerning their roles, responsibilities, plans and strategies, in executing their professional and fiduciary jobs. The not-for-profit industry, albeit not yet regulated, is not immune to criticism and expectations. In the light of this environment, we stress the importance and benefits of developing a formal timetable in which to perform the following:

- Document, review and enhance the Association's key activities and processes;
- Evaluate and test the operating design and effectiveness of those procedures; and
- Commit to updating and refreshing existing policies and procedures within the Association.

As part of this exercise, management should also document the methods, rationale, assumptions and reviews of management judgments and estimates, for review by the Audit Committee, including but not limited to:

- Accounts and loans receivable reserves
- Contributions receivable reserves
- Liabilities and accruals

Lastly, a best practice employed by an increasing number of not-for-profits is to establish a review process of senior management's travel, entertainment and other reimbursable expenses, by type and by month, by a committee of the Board or a designated member of the Board. Such a review should occur periodically, and documented in the minutes of the meeting.

Management's Response

Most of the UUA's key activities and procedures are documented within the Board of Trustees Policy Manual, by the Administration Human Resources Manual, and by the individual staff groups that handle them. We will centralize these existing procedures by the end of this calendar year and create new policies where appropriate. Concurrently, we will schedule reviews of the methods, rationale and assumptions surrounding reserves, liabilities, and accruals with the Audit Committee in that same time frame or as the schedule of the Audit Committee permits.

Additionally, KPMG suggests that a review process for senior management's travel, entertainment and other reimbursable expenses by a committee of the Board or a designated member of the Board be established. We will propose to the finance committee that the Financial Advisor fill this role.



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ACCOUNTING POLICIES, PROCEDURES AND PERSONNEL

It is inevitable that new accounting developments, industry dynamics and personnel turnover will affect the Association. The need for well defined roles, responsibilities and procedures in the accounting area is important to managing the smooth transition of such change factors and to maintain an effective internal control structure.

Management has maintained good internal controls in light of its limited human resources, and has documented some of its key functions; however more comprehensive documentation should be prepared and include the following:

- Overall institutional financial policies
- Accounting system policies and procedures
- Nature and source of accounting entries and required approvals
- Description and frequency of reconciliation procedures
- Financial reporting (internal and external) preparation practices
- Financial reporting review protocols
- Methodology for calculating estimates (reserves and accruals)
- Nature and source of journal entries and required approvals
- Inter-departmental transactions
- Job descriptions, roles and responsibilities

The development of formal accounting and processing standards, and related procedures would benefit management, staff, administration, and facilitate training, efficiency and strengthen internal controls over accounting systems and procedures.

Management's Response

KPMG proposes that we prepare more comprehensive documentation that includes the following:

- Overall institutional financial policies

See comments above. We will consolidate all financial policies by the end of calendar year 2006.



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- Accounting system policies and procedures

We will prepare documentation on our accounting system policies and procedures by the end of the 2006 calendar year.

- Nature and source of routine journal entries and required approvals

By the completion of the 2006 calendar year we will prepare a document that describes our usual working guidelines and the sources of information for journal entries.

- Description and frequency of reconciliation procedures

By the end of the 2006 calendar year we will prepare written documentation of our reconciliation procedures: cash accounts, accounts payable, and accounts receivable, with particular attention to the processes that include interdepartmental reconciliation (fundraising, UUWorld magazine, and Congregational Services).

- Financial reporting (internal and external) preparation and review practices methodology for calculating estimates (reserves and accruals).

By the end of the 2006 calendar we will prepare a document that reviews practices and methodology for calculating reserves and accruals.

- Nature and source of adjusting and closing journal entries and required approvals

This information will be included in the document to be prepared by the end of calendar year 2006.

- Inter-departmental / staff group transactions

This information will be included in the document to be prepared by the end of the 2006 calendar year.

- Job descriptions, roles and responsibilities

Job descriptions are complete, comprehensive, and are reviewed annually.



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FUNDRAISING MANAGEMENT

As the Association receives contributions with a variety of restrictions, with payments scheduled over a period of time, and even consisting of different types of assets, adequate understanding and documentation must be a priority. Those who authorize and record such transactions must be able to report information accurately and also have an adequate understanding of general accounting practices for external reporting. We note that SFAS No. 116, *Accounting for Contributions*, acknowledges that this is a complex area, often requiring subjective evaluation as to what constitutes a recordable gift, an exchange transaction, or a conditional pledge.

In performing our first audit, we have started to gain an understanding of the process. Identification of restrictions and the related means of satisfying restrictions are dependent upon clear and concise coordination between those who authorize such transactions and those who record them.

We offer the following recommendations to further support management's efforts:

- Ensure that Stewardship & Development fundraising information provided to senior management and Trustees is timely reconciled to the financial records maintained by Financial Services staff.
- Reconcile pledges, collections, valuations and revenues between the Stewardship & Development systems and the general ledger periodically (e.g. quarterly).
- Maintain donor/contribution files in a fashion that will allow appropriate independent review of pledges, collections and restrictions.
- Prepare formal detailed policies and procedures for the fundraising operations recommended above.

Management's Response

KPMG suggests:

- Ensure that Stewardship and Development fundraising information provided to senior management and Trustees is timely reconciled to the financial records maintained by Financial Services staff.

This is currently done in a timely fashion and the Stewardship and Development Staff Group has designated a staff person responsible for such exchange of information.



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- Reconcile pledges, collections, valuations and revenues between the Stewardship and Development systems and the general ledger periodically (e.g. no less than quarterly).

This is currently done, typically on a monthly basis and no less frequently than quarterly.

- Maintain donor / contribution files in a fashion that will allow appropriate independent review of pledges, collections and restrictions.

We will, by the end of fiscal year 2006, develop a formal process for such a review.

- Prepare formal detailed policies and procedures for the fundraising operations recommended above.

We will include such policies and procedures in the policy manual to be prepared by the end of calendar year 2006.

FIXED ASSET MANAGEMENT

The Association continues to update its facilities and computer systems. Management has utilized the general ledger system as best as possible to help monitor and control these transactions. The current general ledger system does not facilitate the timely and accurate detail records of plant and equipment, nor the related depreciation on such assets.

We recommend that management develop (or purchase) a system that will provide efficient, comprehensive and accurate means of capturing and tracking all fixed assets and related depreciation. The system should become the central database that will track, account, depreciate and report fixed asset acquisitions, disposals and balances. In addition, once management has the system operational, we would also recommend that procedures be enhanced to facilitate timely and efficient authorization, reconciliation and monitoring of plant and equipment.

Once these processes have been enacted, management should consider the following:

- Perform a full inventory of fixed assets, and develop a periodic cycle inventory plan.
- Revisit the minimum threshold for capitalization
- Analyze leasehold renovations write-offs
- Ensure appropriate calculations of computer system and web-site development costs



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In addition, we recommend that the Association review the estimated useful lives it is using in the current depreciation of its fixed assets, and revise to a more realistic useful economic life, where appropriate.

Management's Response

KPMG suggests that we develop or purchase a fixed asset system and that, when the system is operational, we enhance the following procedures:

- Perform a full inventory of fixed assets, and develop a periodic cycle inventory plan.
- Revisit the minimum threshold for capitalization
- Analyze leasehold renovations write-offs
- Ensure appropriate calculations of computer system and web-site ITS development costs

It remains a long-term goal to have an effective fixed asset system. However, staffing and time limitations have precluded the UUA from identifying and implementing such a system thus far. Purchasing a system to manage fixed assets would appear to be an alternative, though an expensive one. We will locate, review and assess the systems available in anticipation of making a recommendation no later than the end of the 2006 calendar year

We will review our threshold for capitalization and analyze renovations write-offs by the end of the 2006 fiscal year. PC's are tracked on-line via the ITS Staff Group. Useful-life analysis has recently been conducted for PC's and software and the useful life estimate was increased from three years to four years. Website development costs will, beginning immediately, be analyzed separately, so that obsolete elements are not carried as assets.



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BEACON PRESS

Beacon Press is a component unit of the Association and represents a significant portion of the Association's financial position and operations. The Board of Trustees and management have the fiduciary responsibility to manage all activities of the Association, including Beacon Press. In performing our audit, we observed the discrete processes of planning, controlling and monitoring Beacon Press activities. Although Beacon Press monitors its operating results and has a number of financial controls; integration of activities, controls and financial results would result in more effective progress in meeting the mission and objectives of the organization.

We recommend that management consider the following with respect to Beacon Press:

- Synchronization of internal controls
- Periodic "consolidated" financial reporting
- Supervisory review by management

Management's Response

With regard to Beacon Press, KPMG recommends:

- Synchronization of internal controls
- Periodic "consolidated" financial reporting
- Supervisory review by management

Financial reporting is currently consolidated on a quarterly basis, utilizing the information provided by the Beacon Press Chief Financial Officer to the Financial Reporting Manager, the Treasurer, the Executive Vice President, the President, and the Finance Committee. The Director of Beacon Press and the Beacon Chief Financial Officer have signing authority and internal approval requirements that are parallel to the rest of the UUA's financial management policies.

This section seems to suggest that the financial operations of Beacon and the rest of the Association be consolidated. We have explored this option in the past, each time deciding that the nature of the publishing that Beacon does lends itself better to separate financial operations. We will, by the end of fiscal year 2007, explore this option again.



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MONITORING OF SERVICE PROVIDERS

In the course of its operations, management has employed a number of third-party service providers to assist in its accounting responsibilities. Those responsibilities, although outsourced, nevertheless remain with management and must be addressed as though they were performed directly. Payroll servicing, investment management and investment custody represent the most significant functions performed by others. Management should ensure that controls within and surrounding these functions produce complete, accurate and authorized transactions.

At a minimum, we recommend management obtain yearly SAS No. 70 reports (control reviews) of all its service providers. Typical reports identify the controls tested, and the results of those tests. The reports will also disclose those controls and activities that were not tested, and should be addressed by management. As with most external providers, their systems process information precisely as described, therefore controls over the input and output from the service provider is essential for effective internal control over the function.

Management's Response

SAS 70 reports are received from each of the service providers mentioned above. The Endowment staff monitors the UUA GIF Investment Managers regularly. This monitoring process and reconciliation procedure ensures that the managers and Investors Bank & Trust (IBT) have correct positions in the various securities holdings and also the correct price of each security. Cash and cash equivalents are included in this review. The reconciliation is documented on a spreadsheet by the Endowment Accountant as soon as the bank statements arrive each month, and when the Investment Manager Statements are received. One of the Investment Managers provides a position statement quarterly. This reconciliation, called 'Market Value Comparison Report' is part of the regular review process in the Endowment area and any variances are identified and dealt with immediately by calling IBT and/or the Investment Manager in question.



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INVESTMENT ADMINISTRATION

As presented to the Audit Committee in the spring, a key area of KPMG's audit focus was investments and its related accounts. Board appropriated spending rates, investment account reconciliations, earnings and receivables calculations, unitization (pooling) schedules and availing procedures represent some of the significant activities in this area. In conducting our efforts, we gathered an understanding of the integration of reports, processes and controls. Certain aspects of these procedures are manually intensive, and concentrated with certain personnel. Although we had no control concerns or findings in this area, we submit a few recommendations that may result in more effective and efficient controls, and enhance existing investment administration procedures:

- Comprehensively document the methodology, sources, assumptions, reviews and proofs of the investment administration process;
- Document the Association's due diligence procedures for investments, including but not limited to valuing non-marketable securities, obtaining financial statements / internal reviews (SAS No.70) and performing other periodic financial analysis;
- Continue to seek ways to automate and document the matching of available earnings (spending policy / maximum cap) and qualified expenditures (availing process).

Management's Response

We have found the level of controls and analytical output within GIF to be sufficient for most of the Association's planning and spending needs. Some of the restricted funds thus expended are paid to the Current Section on a quarterly basis, and are recorded in a temporarily restricted category until the expenditures are actually made. Other funds, mostly emanating from capital campaigns, are requested from Endowment on an "as-spent" basis and are then transferred to the Current Section as a reimbursement. Expenditures for restricted purposes are documented in the Current Section through the check or wire request and coding process.

In addition, we note that:

The Endowment area has extensive documentation of all of the trading activity that occurs in the UUA GIF and reconciles all accounts on a monthly basis.

The most recent SAS 70 for IBT was provided to KPMG during the FY05 audit.

The matching of the spending policy with qualified expenditures to the



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extent requested by KPMG would require research into new software packages/consultants as well as extensive internal resources to overhaul some of our major reports and coordinating accounting policies.

Management's Response Timeline

Beginning Immediately:

- * Request that the financial Advisor review senior management's reimbursable expenses*
- * Analyze website development costs*

End of fiscal year (June 30, 2006):

- * Develop process for review of pledges, collections and restrictions*

End of calendar year (December 31, 2006):

- * Prepare a comprehensive policy manual that centralizes procedures, policies, working guidelines, and methodologies for financial matters*
- * Prepare a recommendation for a fixed asset management system*

End of calendar year (December 31, 2007)

- * Explore the financial structure between Beacon Press and the rest of the Association*

* * * * *

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 or procedures that may exist. We aim, however, to use our growing knowledge of the Association gained during our work to make comments and suggestions that we hope will be useful to you.

We would be pleased to discuss these comments and recommendations with you at any time.

This report is intended for the information and the use of the Audit Committee of the Board of Trustees, management and others within the Association.

Very truly yours,

KPMG LLP