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October 17, 2006

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, 2006, and have issued our report thereon dated October 17, 2006. 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. In addition, we have included the comments and recommendations initially presented to management (with KPMG's 2006 update in some cases, and those specific items completely addressed by management removed) at the conclusion of our 2005 initial audit, along with management's updated responses and timeline.

POLICIES AND PROCEDURES / SAS NO. 112

In 2006, the American Institute of Certified Public Accountants issued Statement on Auditing Standards (SAS) No. 112, *Communicating Internal Control Related Matters Identified in an Audit*, which is effective for audits of financial statements for periods ending on or after December 15, 2006. The auditor must evaluate identified control deficiencies and determine whether these deficiencies, individually or in combination, are significant deficiencies or material weaknesses. Control deficiencies identified during the audit that are considered significant deficiencies or material weaknesses must be communicated in writing to management and those charged with governance as part of each audit. Examples of circumstances that may be control deficiencies, significant deficiencies, or material weaknesses include the following:

- Inadequate design of internal control over the preparation of the financial statements being audited
- Inadequate design or internal control over a significant account or process
- Insufficient control environment
- Absent or inadequate segregation of duties with a significant account or process
- Absent or inadequate controls over the safeguarding of assets
- Inadequate design of information technology (IT) general and application controls
- Failure in the operation of effectively designed controls over a significant account or process
- Failure of the information and communication component of internal control to provide complete and accurate output because of deficiencies in timeliness, completeness, or accuracy
- Failure to perform reconciliations of significant accounts
- Management override of controls

Consistent with our 2005 comments and recommendations (as follows), a starting point for identifying and evaluating controls, as well as possible vulnerabilities or areas for improvement, is a management review of existing policies and procedures. In light of new standards and regulations such as SAS No. 112, emphasizing internal control and the need for written, up-to-date policies and procedures is greater than ever. It is also inevitable that other new accounting and auditing developments, industry dynamics and personnel turnover will affect the Association’s continuing need for up-to-date documentation. The need for well-defined roles, responsibilities and procedures is important to assuring the smooth transition of such change factors and to maintaining a strong internal control structure.

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. It would also provide the critical first-step in identifying internal controls so that best practices may be considered and applied by the Board and senior management in the future and in light of the new definitions contained in SAS No. 112.

We also emphasize that these formalized documentation procedures should be incorporated into a year-round process, and not just done at year-end solely to accommodate external audit needs.

Management's Response

Management has carefully reviewed SAS No. 112, and believes that a top to bottom analysis of the Association's controls and potential vulnerabilities is a useful step to undertake at this time. Consistent with the recommendations of the UUA's auditors and management's response last year, management has begun a process of consolidating all financial policies and procedures and updating the respective documentation. While some progress has been made, much of the work was put on hold during the transition from the retiring treasurer to the new treasurer who took office in August. Now that the 2006 audit is complete, the treasurer will make the review and documentation of control policies and procedures a top priority. See below for the specific timeline.

ALTERNATIVE INVESTMENTS

In July 2005, the American Institute of Certified Public Accountants (AICPA) issued an Auditing Interpretation (AU Section 9332) addressing the issues surrounding auditing investments in securities where a readily determinable fair value does not exist. The Interpretation clarified that obtaining a statement or confirmation for investments in aggregate (as opposed to on a security-by-security basis) from a third party does not constitute adequate audit evidence with respect to existence. It also clarified that simply receiving such statement or confirmation (whether in aggregate or on a security-by security basis) from a third party does not in and of itself constitute adequate audit evidence with respect to valuation.

In addition, the Interpretation reiterated that *"management is responsible for making the fair value measurements and disclosures included in the financial statements. As part of fulfilling its responsibility, management needs to establish an accounting and financial reporting process for determining the fair value measurements and disclosures, select appropriate valuation methods, identify and adequately support any significant assumptions used, prepare the valuation, and ensure that the presentation and disclosure of the fair value measurements are in accordance with generally accepted accounting principles."*

While the Association has just begun investing in these types of investment vehicles, and has undertaken the task of enhancing its documentation, we recommend that management continue to expand and strengthen documentation of the policies and procedures in place and ensure that they are consistently applied and satisfy the requirements of the Interpretation. The AICPA has recently issued *A Practice Aid for Auditors: Alternative Investments – Audit Considerations* which includes illustrative examples of initial due diligence, ongoing monitoring and financial reporting controls. The Association should review this guidance and determine if any additional control procedures are required to enhance its valuation process.

Management's Response

Management is aware of the potential difficulties of valuing so-called alternative investments. In the process of creating its FY 2006 financial statements, management conducted a valuation review of these investments. Going forward, management intends to periodically confer with alternative investment managers regarding the underlying values of assets in their portfolios and consistency with stated investment management objectives. Further, management will recommend to the UUA's investment committee and to the UUA's investment consultant that in the evaluation of managers of alternative investments consideration be given to their willingness to provide adequate information for the UUA to value its own assets.

STATUS OF PRIOR YEAR OBSERVATIONS

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

Management's Updated Response and Timeline

Most of the UUA's key activities and procedures are documented within the Board of Trustees Policy Manual, the Administration Human Resources Manual, and the individual staff groups that handle them. In response to KPMG's recommendations last year, we are in the process of centralizing this documentation and creating new policies and procedures where appropriate. Concurrently, we will schedule reviews of the methods, rationale and assumptions surrounding reserves, liabilities, and accruals with the Audit Committee.

The new treasurer, who began working full-time in August, is making this a high priority following the completion of the audit. We have already collected all of the policy and procedure documents currently in effect. Over the next several months, we will consolidate them and address any gaps. We expect this process to be completed by March 30, 2007.

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

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 Updated Response and Timeline

See comments above. We will consolidate all financial policies by March 31, 2007.

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:

- 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.

KPMG's 2006 Update

In 2006, the Association solicited and received contributions to support Hurricane Katrina-related programs. The undistributed portion of those restricted contributions was not recorded properly in the financial statements submitted to us for audit. The recognition, release, recordkeeping and reporting of contributions, primarily related to this type of temporarily restricted net assets, involves the knowledge and review of many persons, and should be reviewed by others outside direct authorization and recordkeeping personnel involved. Specifically, the Association should follow the precepts outlined in SFAS 116, *Accounting for Contributions*, pertaining to the accounting for contributions and their subsequent release from restriction.

Management has considered our suggestions, and made progress in this area. We wish to re-emphasize the importance of completing the remaining aspects of our recommendations.

Management's Updated Response and Timeline

Management will, by March 31, 2007, create a filing system to allow independent review of pledges, collections and restrictions. We will also develop policies and procedures relating to fundraising operations, including the precepts outlined in SFAS 116, by the end of this fiscal year.

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

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 Updated Response and Timeline

We are on track to assess fixed asset systems in anticipation of making a recommendation by March 31, 2007.

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:

- Application of Association-wide internal control practices, such as the following:
  - Form and timing of account reconciliations
  - Documentation of reserves, allowances and other estimates
  - Recognition and release of restricted net assets (contributions)
- Periodic "consolidated" financial reporting
- Supervisory review by management
- Incorporation of Beacon Press - specific controls within the Association's policies and procedures manual

Management's Updated Response and Timeline

The incoming treasurer will establish new practices with regard to Beacon Press. He will meet with the Beacon CFO monthly to review financial performance and on a quarterly basis will review financial statements and sensitive reconciliations, such as inventory and returns. He also attends the meetings of the Beacon Press advisory board. Further, the Beacon Press CFO is being more closely integrated into the UUA financial services team. We have agreed that by the end of the 2007 fiscal year, the treasurer will be in a position to make recommendations regarding any changes to Beacon's financial structure within the Association should such be judged necessary. UUA management will develop written guidelines for financial oversight of Beacon Press, including consideration of KPMG's suggestions above, by March 31, 2007.

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 out-sourced, 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.

The typical SAS 70 reports received by management for each of these functions 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.

KPMG's 2006 Update

Management should review the scope and results of each SAS No. 70 report in detail and consider the following:

- operational and control areas not tested / covered by the reports, as applicable,
- the impact of findings / exceptions included therein, and
- control functions communicated by the service provider that indicate they are the responsibility of the organization.

Based on management's review of the preceding, supplemental controls, policies and procedures should be developed to address the relevant unaddressed control risks. Management should also consider if any changes have been made to the service provider's processes and if those changes necessitate changes to management's control structure.

If any findings are included in the report, management should consider what, if any, impact those finding may have on management's ability to rely on the service provider's accounting and reporting, and if management has or needs a mitigating control to detect an error in a timely fashion.

Management may wish to visit, or invite, representatives of the service provider and refine the interaction and reliance between both parties.

Finally, management should document the results of its reviews of the SAS No. 70 reports and discussions with the various providers in memoranda evidencing such due diligence.

Management's Updated Response and Timeline

It is currently management's practice to obtain SAS No. 70 reports from firms to which it outsources accounting functions. We review these reports to confirm that the reports are "clean" opinions and that there are no material concerns expressed by their auditors. In the future, management will undertake a more thorough review and analysis of the SAS No. 70 reports as suggested in this comment. Based on that, we will develop and document appropriate control procedures. This process will be in place by the end of the current fiscal year.

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:

- 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).

KPMG's 2006 Update

Management should consider the following suggestions in developing its approach:

- Specify the timing of procedures (such as reconciliations) and the persons responsible
- Identify the sources of materials to be used in the procedures (such as statements, memos or other communications)
- Document any exceptions / adjustments to the information provided from sources (incorrect fair values or account charges)
- Evidence completion, outcome, conclusion and supervisory review of the procedures
- Dedicate a specific set of accounts / sub accounts to accumulate like transactions and activity, for periodic verification on a quarterly or yearly basis (unbundled transactions and edits)
- Test the valuation of marketable securities in the portfolios

Management's Updated Response and Timeline

As a part of the review and documentation of accounting policies and procedures discussed above, we will consider KPMG's suggestions on endowment management and prepare new documentation by March 31, 2007.

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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