Financial Advisor's Report
To Unitarian Universalist Congregations

June 2010

UNITARIAN
UNIVERSALIST
ASSOCIATION OF
CONGREGATIONS

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http://www.uua.org/aboutus/governance/officers/financialadvisor/index.shtml

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"The Financial Advisor is a volunteer elected by the General Assembly to serve as your best assurance that the UUA is behaving in a fiscally responsible manner. The Financial Advisor provides the President, Board of Trustees, and General Assembly with an independent and expert evaluation of financial issues and the fiscal health of the UUA. The Financial Advisor also recommends changes that will improve the quality of fiscal planning and management of the UUA."

-- Larry Ladd, UUA Financial Advisor (1997-2005)

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Financial Reports

More information about the UUA's recent financial results can be found in these two reports:

- The UUA Treasurer's Report provides a detailed explanation of the Association's financial condition, along with explanatory figures and charts, as well as the UUA administration's analysis of this material. The Treasurer's Reports can be found on the UUA website at http://www.uua.org/aboutus/finance/25499.shtml

- The Independent Auditors' Report on Fiscal Year 2009, by the accounting firm KPMG, presents audited financial statements for the Association, including a balance sheet ("Statement of Financial Position"), an income statement ("Statement of Unrestricted Revenue and Expenses"), and many supporting schedules, including detailed information about the UU Common Endowment Fund. This report is at http://www.uua.org/aboutus/governance/board-appointedcommittees/auditcommittee/index.shtml

These two reports accurately and comprehensively describe the UUA's financial results. Therefore, in my report I'll avoid repeating information from the other reports, but will instead focus on broad highlights and on particular topics of importance.

My previous reports to General Assembly and to each quarterly meeting of the UUA Board are available at http://www.uua.org/aboutus/governance/officers/financialadvisor/6760.shtml.

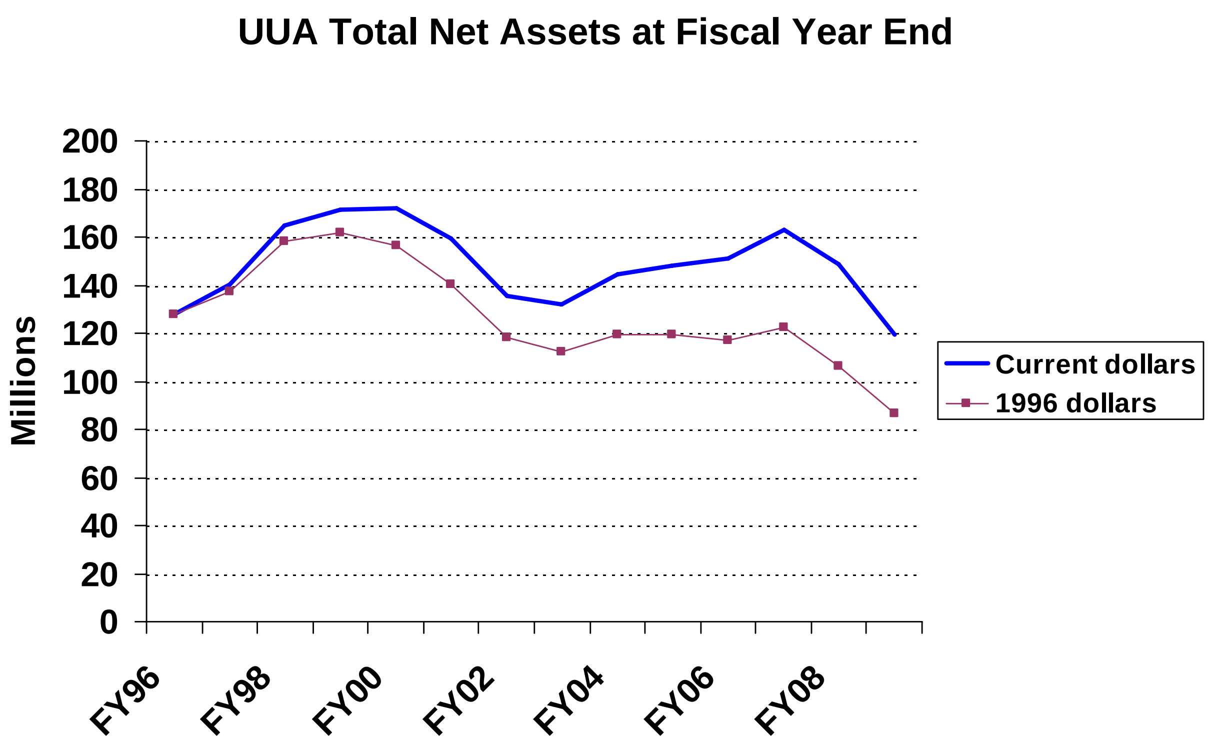
Fiscal Year 2009

Financial Results

The surplus or deficit in the operating budget is probably the most important measure of the fiscal health of a nonprofit organization like the UUA. In the UUA's audited financial reports, this number is called the "change in unrestricted net assets from operations." For FY09, which ended June 30, 2009, this number was a negative $5,000, which is so close to zero that it means that the UUA's operating budget did not experience either a surplus or a deficit for the year.

However, the stock market decline that began during FY08 continued during FY09. As a result, the total value of the UU Common Endowment Fund (UUCEF), including funds invested by congregations, which had fallen by $14 million during FY08, decreased by an additional $24 million in FY09. (However, the fund has increased sharply as the stock market has rebounded since the spring of 2009.)

The value of the endowment is the largest component of the UUA's "total net assets," the level of which is another important measure of its fiscal condition. This figure starts with everything the organization owns, and then subtracts all its debts. The chart below shows how the UUA's total net assets have changed since FY96. Sharp growth during the "dot-com" boom of the late 1990's was followed by a substantial decline when the stock market collapsed in 2000. Assets then grew steadily until the recession and bear market began in late 2007.



From 1996 through 2009, the Association's net assets fell slightly, even without taking into account the impact of inflation. Measured in "real" 1996 dollars, the UUA's net assets have declined by 32% over the last 13 years. This decline, and the corresponding drop in income from the endowment, contributed to the need to make major cuts in spending during the preparation of the FY10 and FY11 budgets.

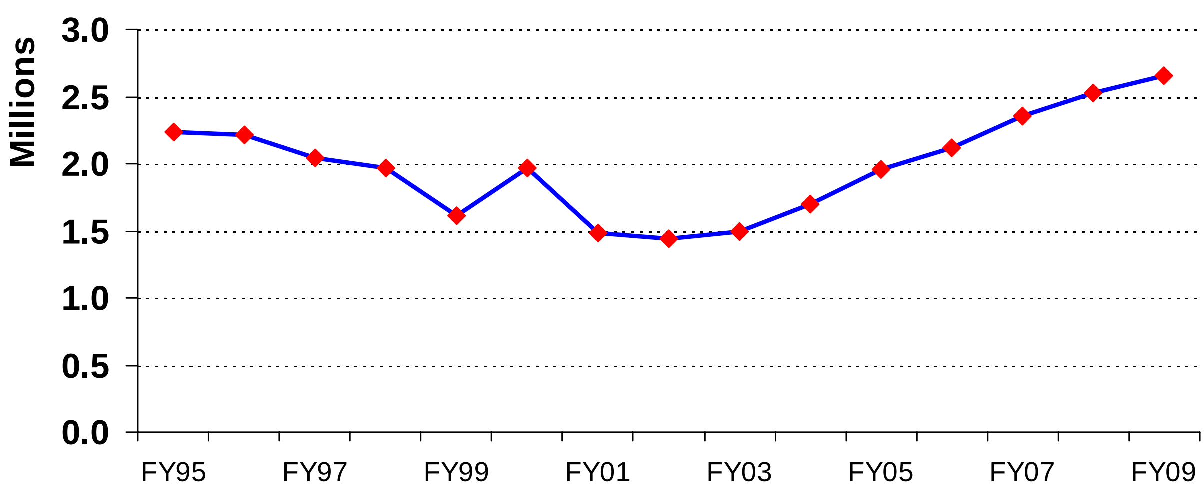
While fluctuations in the value of the endowment are inevitable, an endowment spending policy can insulate the current operating budget from the impact of these changes. The UUA Board has recently changed its endowment spending policy with this goal in mind, as I discuss below in the section on Endowment Spending Policies.

Beacon Press

Beacon Press achieved an operating surplus of $156,000 in FY09, for its seventh consecutive year of surpluses. As a business in the volatile publishing industry, Beacon's sales revenue and net income will fluctuate. In 2006, the UUA Board reaffirmed its expectation that Beacon should not incur a deficit of more than $300,000 in any year or $600,000 in three years.

In response to the weak national economy, Beacon carried out several cost-cutting measures that permitted it to avoid a deficit in FY09. Beacon again expects to produce a small surplus in FY10 and to achieve a balanced budget in FY11.

Net Assets ("Stabilization Fund") Balance at Year End

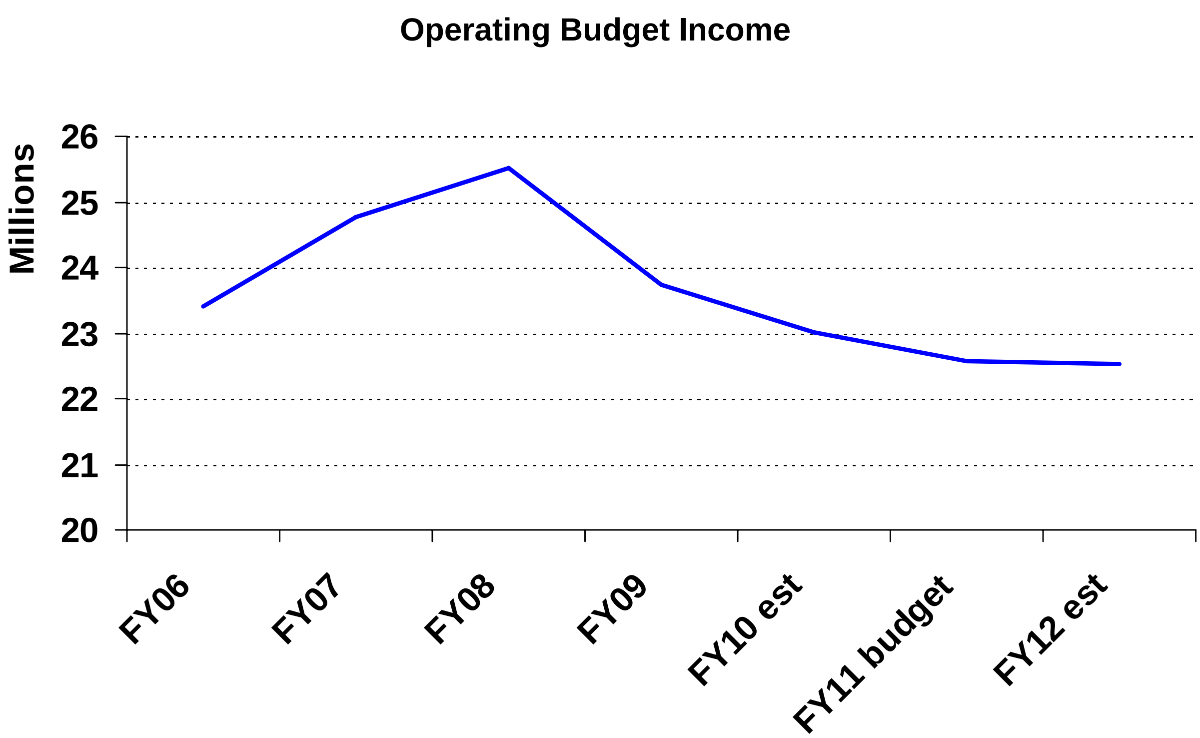


The chart shows Beacon's year-end net assets, which I regard as a "stabilization reserve." These funds can be used to finance publishing opportunities, such as the recent acquisition of the rights to publish the writings of the Rev. Martin Luther King, Jr. The funds are also available to avoid the need to draw down other Association assets should Beacon experience operating deficits. The net assets of the press have grown by more than $1.2 million in the past seven years. With a reserve of more than $2.6 million at the beginning of FY10, Beacon and the UUA are well-protected.

Fiscal Year 2010 and Beyond

The recession that began in December 2007 has made the last three fiscal years extremely difficult for the UUA as well as for many of our congregations and members.

Total UUA income fell by $3.6 million, or 10%, from FY08 to FY09. The budgets for FY10 and FY11 were based on predictions that income would continue to fall in each fiscal year. In the operating segment of the budget (which excludes Beacon Press, General Assembly, the building loan fund, and endowment assets), total FY11 income is expected to be $22.6 million, compared to $25.5 million in FY08. While the administration is not predicting a further decline in income for FY12, it expects no increase, either. This chart shows the trend in available income:



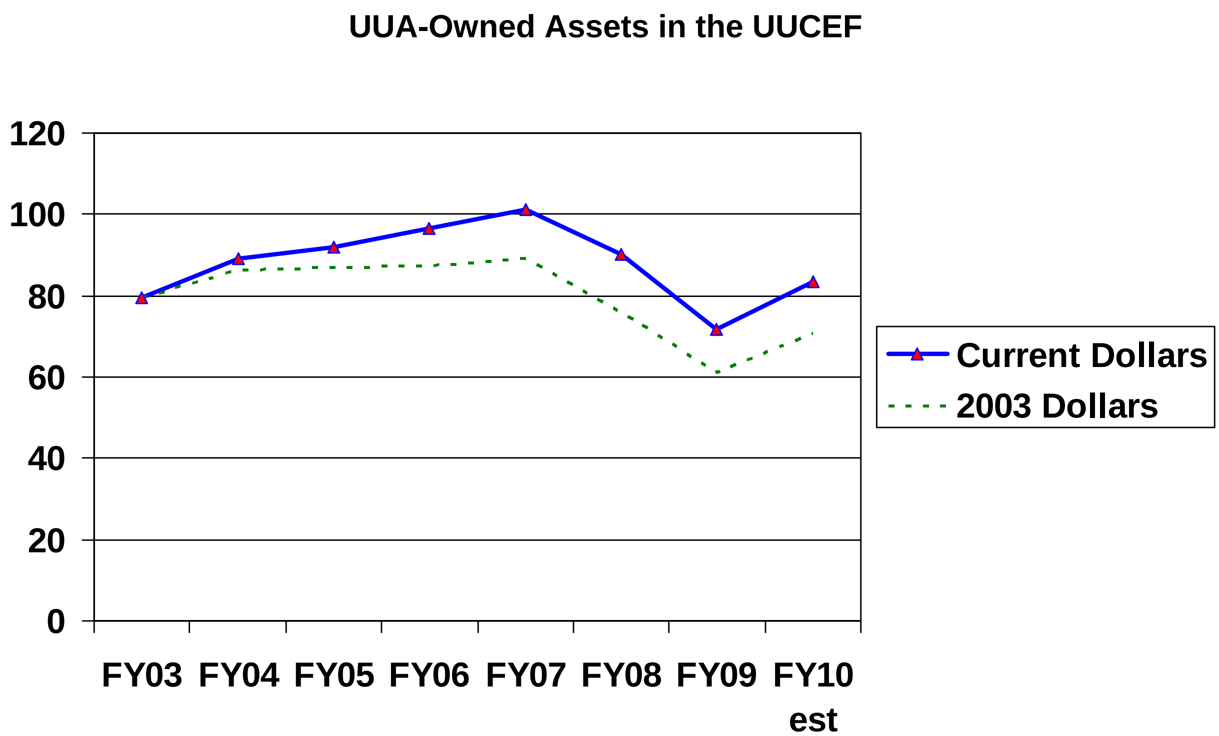
Balancing the FY10 and FY11 budgets has required significant cuts in spending, including personnel savings through both layoffs and attrition. I believe that both the Sinkford and Morales administrations have acted responsibly in making these painful, though necessary, reductions in spending.

Endowment Management

After several years of strong growth, the UUA endowment lost money in FY08 and again in FY09. In FY09, the total value of the assets held in the UU Common Endowment Fund (or UUCEF, formerly called the "General Investment Fund") fell from $123 million to $99 million. The total return of the fund was negative 16%[1]. By contrast, the unmanaged S&P 500 stock index fell by 28% during the same period.

During the first nine months of FY10, the UUCEF has rebounded significantly, with total return of 22%. The UUCEF's performance for the past one, three, and five years has put it in the top quarter of similar-sized endowment funds in the nation. This excellent performance reinforces my conclusion that congregations that manage their own endowments should consider investing it in the UUCEF.

The chart below tracks the value, both in current dollars and in inflation-adjusted dollars, of the portion of the UUCEF that is owned by the UUA. It shows that the value of our endowment has fallen in real value since FY03.



[1] The value of the UUCEF fell by more than 16% during FY09 because of routine distributions to the UUA and other fund owners.

Endowment Spending Policies

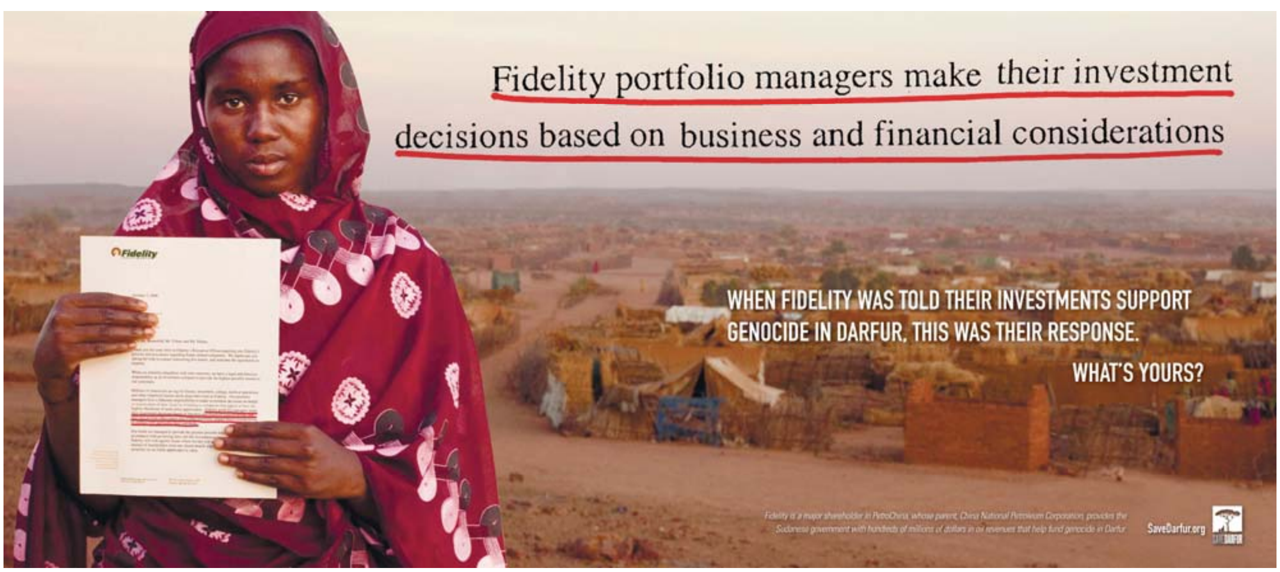
In January 2010, the UUA Board of Trustees approved a new policy designed to reduce the volatility in endowment spending. The previous policy, which was similar to that used by most endowment funds, tried to reduce volatility by basing spending on a multi-year average of the value of the endowment. But a major market decline still required substantial spending cuts. The prior policy reduced allowable endowment spending by 25% in just three years after the stock market peak in 2000.

In response to this sort of problem, many American universities that depend heavily on endowment have developed spending policies that minimize year-to-year fluctuations in allowable spending while also protecting the inflation-adjusted value of the endowment. Yale pioneered this approach, which has been adopted by Stanford, Dartmouth, and others.[2]

The new UUA policy follows this precedent. It requires the Association to set aside more money in years of strong endowment performance in order to prevent the need for spending cuts during downturns. I'm confident that this prudent policy will reduce the volatility of our endowment spending in the coming years.

Pension Plan Recordkeeper

The UUA General Assembly adopted a resolution in 2005 demanding an end to crimes against humanity in Darfur. Fidelity Investments, the large mutual fund and financial services company, has been one of the main targets of the "Save Darfur" campaign. In 2007, UUA President William G. Sinkford urged Fidelity to divest from companies doing business with the Sudanese government as a way to cut support for the genocide in Darfur.



[2] A paper by Callan Associates discusses these policies: http://www.callan.com/research/download/?file=papers/free/54.pdf

At the same time, Sinkford asked the UUA Compensation, Benefits, and Pension Committee to consider whether the UUA should continue to use Fidelity to provide recordkeeping services to the UU Organizations Retirement Plan. The UUA's contract with Fidelity had not been reviewed in the prior ten years.

The Committee is composed of two active ministers, a retired minister, the spouse of a retired minister, four experts on financial and human resource management, the UUA Treasurer, and the UUA Financial Advisor. Five of the ten Committee members are participants in the plan.

In 2008 the Committee issued a request for proposals for recordkeeping services, and received adequate proposals from two firms, Fidelity and TIAA-CREF. TIAA-CREF serves as recordkeeper for more than 15,000 retirement plans with 3 million participants, mostly in higher education but also in the non-profit and government sectors.

The Committee considered four broad issues in evaluating the two firms:

- Recordkeeping, customer service, and administrative capacity
- Investment performance and fees
- Ease of transition
- Compatibility with the mission of the Unitarian Universalist Association

Recordkeeping, Customer Service, and Administrative Capacity

The Committee retained Angell Pension Group to evaluate the administrative and participant service capabilities of Fidelity Investments and TIAA-CREF, including their capacity in the areas of customer service, communications, education, and recordkeeping. Angell reported its conclusion as follows:

> "The proposed recordkeeping and administrative services for Fidelity and TIAA-CREF have more similarities than differences. No single issue eliminates either from consideration."

In addition to the evaluation performed by Angell, UUA staff members carefully examined the capabilities of both companies. Their work included site visits to both vendors' operations centers. Their conclusion was that TIAA-CREF has the capability to provide the same level of service to the UUA and to plan participants that Fidelity has offered.

The Committee paid particular attention to the quality of customer service that individual plan participants, congregations, and the UUA staff could expect to receive in their dealings with the recordkeeper. Relating to participants, this included statements, telephone contacts, on-line access to accounts and information, and in-person access. For congregations and the UUA, this included dealing with contributions and reports. The Committee and the UUA staff have concluded that TIAA-CREF offers a high level of customer service and responsiveness to queries and issues. During discussions with the Committee, TIAA-CREF made an especially strong commitment to providing outstanding service to the UUA's plan participants and to the UUA, including offering enforceable performance guarantees.

Investment Performance and Fees

The Committee retained Fiduciary Investment Advisors (FIA) to negotiate with Fidelity and TIAA-CREF to develop for each firm a recommended menu of investment choices that would be available to participants in the Plan. FIA concluded that significant changes in the fund menu were warranted even if the UUA retained Fidelity as recordkeeper.

After extensive negotiations with each firm, FIA recommended a menu of choices for each firm that would, when compared to the current fund menu, provide higher return, broader opportunities for diversification, and lower fees. FIA concluded that the selection of either firm would be prudent.

Ease of Transition

Because FIA recommended that the preponderance of the money in participants' accounts should be moved to different mutual funds even if Fidelity is retained, there will be some transition issues regardless of which firm is selected. Both Angell and FIA concluded that the transition will not be difficult for participants, because all existing investments will be "mapped," or automatically transferred, to a new fund that is similar in investment characteristics. Participants will be given the option, but will not be required, to make changes to their investment mix.

Mission Compatibility

In the years since the 2005 UUA General Assembly voted "that Unitarian Universalists should advocate for immediate action to end the crisis in Darfur," UUs have been active in efforts to end the genocide in Darfur.

In 2007 the Save Darfur Coalition called on Fidelity to "stop investing in companies that fund genocide in Darfur." In the first three months of 2007 Fidelity sold 90% of its Darfur-related stock, while stating that the sales were unrelated to outside pressure, and then persuaded media companies to pull scheduled ads by SaveDarfur.org that were critical of the firm's investments in the Sudan.

During discussions with the Committee, Fidelity explained its refusal to divest as follows: "We have concluded that when it is appropriate to remain actively invested in a company, we will do so, thus retaining the ability to oppose company practices that we do not condone." However, a senior Fidelity official also told the Committee that "we do not have an active program in shareholder advocacy and shareholder engagement."

In January 2010, TIAA-CREF announced that it had divested from four firms linked to genocide in Sudan, prompting the Unitarian Universalist Service Committee to report that, "In a major victory for activists in the Sudan divestment campaign, TIAA-CREF has become the first large U.S. investment management company to sell its shares of Asian energy companies because of their failure to take meaningful steps to help end the genocide in Darfur."

In the broader area of shareholder advocacy, TIAA-CREF also has a superior record to that of Fidelity. The UUA sponsored 18 shareholder resolutions on various subjects in 2008 and 2009, only 5 of which were supported by Fidelity.

By contrast, TIAA-CREF is a leader in socially responsible investing, including the full range of environmental, social and governance issues as expressed through its record of corporate engagement, social screening of investments, and community investing. TIAA-CREF supported 17 of the 18 UUA-sponsored shareholder resolutions in 2008 and 2009.

The non-profit heritage of TIAA-CREF and its demonstrated record of workplace diversity and transparent corporate governance make it a highly desirable business partner for the UUA.

After reviewing the records of the two firms, the UUA Committee on Socially Responsible Investing wrote to "strongly recommend choosing TIAA-CREF as the retirement plan record-keeper."

Angell Pension Group reported its conclusion as follows:

> "All things being considered as outlined above and after factoring all fiduciary considerations to make an informed and prudent decision on behalf of the participants, if mission compatibility is an institutionally important decision making factor to UUA, then TIAA-CREF may be the more appropriate choice."

Committee Recommendation and Board Action

On April 8, 2010, the Committee **unanimously** voted to recommend that the UUA Board hire TIAA-CREF as recordkeeper for the pension plan. The UUA Board is scheduled to vote on this recommendation in May, after the deadline for the submission of this report. I am confident that the Board will accept the Committee recommendation. I'm proud that the Association is taking this step to align our practices with our values.

UUA Health Plan

The UUA Health Plan has completed three years of service, and has been a huge success. Membership in the plan grew by 6% during 2009, and the plan now serves 768 enrollees and retirees as well as 550 dependents in 300 congregations.

Plan Results

The plan generated a surplus of $121,000 in 2009 on revenues of $6.3 million. As of the end of 2009, the plan had accumulated a surplus of $2.5 million. This surplus will be carried forward on the books of the health plan to cushion against premium increases in future years and to serve as a reserve against future losses. It cannot be used for any other UUA purpose.

The plan's strong performance has allowed its board of trustees, on which I serve, to hold premium increases to a minimum while making some improvements in benefits. Over the past three year period, when cumulative increases of 30 to 40% in health insurance premiums have been common among other plans, the base[3] premium in the UUA plan has risen by only 15%.

The Future of the Plan

The health care reform law passed in early 2010 continues to make employer-based health plans the foundation of the nation's system for financing health care. Therefore, we have an obligation to work to assure the continued success of the UUA Health Plan.

The plan is most likely to succeed in the long term if 1000 or more employees, including some who now have health insurance from other sources, enroll in the plan. Achieving such an enrollment level will require a considerable financial commitment by many congregations that do not now provide health insurance to their minister or other staff. (Congregations that join the UUA Health Plan are asked to pay at least 80% of the cost of the health insurance premiums for their participating employees. Many congregations also choose to pay a portion of the added cost of dependent coverage.)

In today's economy, it may be difficult for some congregations to maintain, let alone expand, the health insurance benefits they provide to their employees. However, I believe that congregations have a moral responsibility to do so. Employees who lose their health insurance are often unable to find health insurance at any price, and certainly not at an affordable price.

All congregational employees who work at least 750 hours a year (the equivalent of a half-time job during the church year) are eligible to participate in the plan. The Health Plan staff estimates that about 90% of eligible employees now have coverage either through the UUA Health Plan, through a different plan offered by the congregation, or through dependent coverage on a spouse's or partner's plan. Our goal is to have **100%** of eligible employees covered by health insurance.

As I have done for the past four years, I strongly urge **all** congregations, including ones that obtain health insurance from other sources as well as ones that do not now provide insurance to their ministers and other employees, to participate in the UUA Health Plan.

Bylaws Change to Permit Enforcement of Whistleblower and Conflict of Interest Policies

I reported to the General Assembly last year that in April 2009, the UUA Board adopted policies on Whistleblower Protection and Conflict of Interest that were drafted by the Audit Committee. I am gratified that the board has adopted these important policies to enhance ethical conduct by UUA employees, office holders, and volunteers.

[3] Premiums are based on the enrollee's age and geographic location. The actual premium increase for any enrollee is a combination of the base premium increase for the entire plan (which is set by the trustees of the plan), the individual's age adjustment (which is always an increase), and the geographic adjustment (which may be an increase or a decrease).

The goal of the Whistleblower Protection policy is to discourage improper activities and to assure UUA employees and others that they may report improper activities without fear of retaliation. The new, comprehensive Conflict of Interest Policy applies to all trustees, staff, and committee members. The policy gives the UUA board the authority to decide whether a conflict exists for trustees and for members of elected or board-appointed committees.

As I reported last year, the new policies authorize the UUA Board of Trustees to sanction or remove board or committee members who commit a material violation of a UUA policy. A change in the UUA bylaws is required to permit the removal of a board member or a member of an elected committee, since such individuals may now be removed only if they are determined to be "incapacitated or otherwise unable to carry out the duties of the office."

I believe that it is appropriate to give the UUA Board the authority (which would require a three-fourths vote) to remove "for good cause" a board member or a member of an elected committee. Many other non-profit organizations, including the UU Service Committee, have similar bylaws provisions. I am confident that it would be used only in cases of serious violations of laws, ethics, or UUA policies. I support the bylaws change, which is on the agenda of the 2010 General Assembly.

Future Topics

In the remaining three years of my term as Financial Advisor, I will work with the UUA administration and Board of Trustees to address the following topics:

- Continued improvements to UUA financial reporting
- Accounting for unrestricted gift and bequest income
- The role of the Liberal Religious Charitable Society (LRCS) and other organizations that hold funds to benefit the UUA and UU-related purposes
- Management of debt, cash, and short-term investments
- Facilities renewal policies

It is an honor and a privilege for me to continue to serve our Association.