Vavrinek, Trine, Day & Co., LLP
Certified Public Accountants & Consultants

VALUE THE DIFFERENCE

June 3, 2004

Joan Diamond
Nautilus of America, Inc.
125 University Avenue
Berkeley, CA 94710

Dear Joan:

In planning and performing our audit of the financial statements of Nautilus of America, Inc. for the year ended June 30, 2003, we considered its internal control structure to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control structure.

However, during our audit we became aware of a few matters that are opportunities for strengthening internal controls and operating efficiency. The following summarizes our comments and provides recommendations regarding those matters. This letter does not affect our report dated July 15, 2003 on the financial statements of Nautilus of America, Inc.

CASH

Comment
We noted that cash balances in bank accounts substantially exceeded the Federal Depository Insurance Corporation's cap on insured cash deposits.

Recommendation
We recommend the board consider the degree of risk associated with a potential bank failure that could cause the loss of much of the Organization's cash balances. Only the first $100,000 in any bank is insured by federal insurance. The Organization may also need to take into the planned timing for the use of the cash and the complications using separate banks may cause in the need for frequent transfers between bank accounts. It may be possible to limit the exposure by transferring bank accounts with funds that are accessed infrequently, such as the reserve account, and the various CD's to separate banks.

Comment
We noted the accounting records for the petty cash account show a total of $165 in petty cash. We were unable to locate a policy as to the established amount of the petty cash account.

Recommendation
We recommend that the established amount of the petty cash fund be documented in an accounting polcies manual and that the trial balance be reconciled to this established amount periodically.

Comment
We noted the checking account was not reconciled at the year end which caused delays in the completion of the audit while the records were reconciled.

Recommendation
Month end closing procedures should include bank reconciliations processes.

SEGREGATION OF DUTIES

Comment
Due to the small size of the organization and the relatively high cost of hiring additional accounting employees, there is a lack of segregation of duties in many of the accounting functions.

Recommendation
We understand that it is not feasible for the organization to have a full segregation of duties and recommend that the organization compensate by regular review and sign off of account reconciliations and large disbursements by someone outside of the accounting function, such as the executive director or a member of the board.

STATUS OF PRIOR YEAR COMMENTS

ACCOUNTING POLICIES

Comment
We noted that the documentation of accounting policies and procedures was begun but not completed. The organization has been in the process of updating and documenting the policies followed by the accounting function in performing daily tasks, however the process of finalizing those policies is still in progress.

Recommendation
As the new accountant becomes more familiar with the organization and the specific areas of responsibility, we encourage the organization to continue its effort to finalize the accounting policies and procedures. The documentation of these policies and procedures is of great importance to a smooth transition should an individual involved in recording accounting transactions no longer be employed by the organization.

Status
Implemented.

Comment
We noted that the organization does not have a minimum level below which capital equipment and improvement purchases are expensed.

Recommendation
We recommend that the organization adopt a capitalization threshold and expense any amount below that threshold in order to not require the internal accounting department to capitalize and track small expenses through depreciation for several years. Common nonprofit organization capitalization threshold levels are $500 or $1,000.

Status
Implemented.

CASH

Comment
We noted that cash balances in bank accounts substantially exceeded the Federal Depository Insurance Corporation's cap on insured cash deposits.

Recommendation
We recommend the board consider the degree of risk associated with a potential bank failure that could cause the loss of much of the Organization's cash balances. Only the first $100,000 in any bank is insured by federal insurance. The Organization may also need to take into the planned timing for the use of the cash and the complications using separate banks may cause in the need for frequent transfers between bank accounts. It may be possible to limit the exposure by transferring bank accounts with funds that are accessed infrequently, such as the reserve account, and the various CD's to separate banks.

Status
Not implemented – see current year comments.

Comment
We noted the accounting records for the petty cash account show a total of $165 in petty cash. We were unable to locate a policy as to the established amount of the petty cash account.

Recommendation
We recommend that the established amount of the petty cash fund be documented in an accounting polcies manual and that the trial balance be reconciled to this established amount periodically.

Status
Not implemented – see current year comments.

INTERNAL ACCOUNTING

Comment

We noted many trial balance accounts that were not reconciled at the year end. We also noted that the trial balance was cumbersome to work with where the assets and liabilities were separated by program and required substantial additional analysis by the Organization's new accountant and caused significant delay in the completion of the audit.

Recommendation

At least annually, the accounting function should reconcile all asset and liability accounts to various subsidiary schedules. For example, cash per the trial balance should be matched to the bank reconciliations, accounts payable per the trial balance should be reconciled to the outstanding list of bills due, etc. We suggest considering consolidating the programs for the asset and liability accounts and leaving only the income and expense accounts segregated by program. This will facilitate the ability to reconcile the cash balances per the trial balance to the bank reconciliations. We also suggest the Organization consider the desirability of continuing to use the accounting software package used in 2002 or evaluate switching to a simpler software system.

Status

Partially implemented – see current year comments.

SEGREGATION OF DUTIES

Comment

Due to the small size of the organization and the relatively high cost of hiring additional accounting employees, there is a lack of segregation of duties in many of the accounting functions.

Recommendation

We understand that it is not feasible for the organization to have a full segregation of duties and recommend that the organization compensate by regular review and sign off of account reconciliations and large disbursements by someone outside of the accounting function, such as the executive director or a member of the board.

Status

Not implemented – see current year comments.

This report is intended solely for the information and use of the Board of Directors, management, and others within the organization. We would be pleased to discuss these matters in further detail at your convenience, to perform an additional study of them, or to assist you in implementing the recommendations. We would like to express our appreciation of the courtesy and cooperation extended to us by the staff of Nautilus of America, Inc. during the audit.

Vavrinek, Trine, Day & Co LLP

Pleasanton, California
July 15, 2003