

THE TECH MUSEUM OF INNOVATION

**Financial Statements
December 31, 2004 and 2003**

**Together With
Independent Auditors' Report**

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
The Tech Museum of Innovation

We have audited the accompanying statements of financial position of The Tech Museum of Innovation (the "Organization") as of December 31, 2004 and 2003, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Organization at December 31, 2004 and 2003, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 16 to the financial statements, the Company has restated its 2003 financial statements to conform with accounting principles generally accepted in the United States of America by capitalizing cost related to self-constructed assets.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 21, 2005, on our consideration of the Organization's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audits.

Our audits were performed for the purpose of forming an opinion on the basic financial statements of the Organization taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

A handwritten signature in cursive script, reading "Ingrid San Felipe".

San Jose, California
January 21, 2005

Cash and cash equivalents	\$ 359,775	\$ 986,689	\$ 35,125	\$ 1,381,589	\$ 104,113	\$ 864,295	\$ 890,099	\$ 1,858,507
Investments	118,376	-	11,967,378	12,085,754	151,505	-	10,637,839	10,789,344
Grants receivable, net	4,192	-	-	4,192	128,891	-	-	128,891
Other receivable	530,491	101,960	-	632,451	465,316	75,000	-	540,316
Prepaid expenses and other assets	1,089,388	-	-	1,089,388	1,395,723	2,250	-	1,397,973
Inventory	202,383	-	-	202,383	196,189	-	-	196,189
Contributed support receivable, net	-	-	1,307,548	1,307,548	-	138,509	2,090,546	2,229,055
Receivable for contributed use of facility, net	-	22,053,432	-	22,053,432	-	22,129,652	-	22,129,652
Property and equipment, net	12,973,443	-	-	12,973,443	15,585,715	-	-	15,585,715
LIABILITIES AND NET ASSETS	\$ 15,278,048	\$ 23,142,081	\$ 13,310,051	\$ 51,730,180	\$ 18,027,452	\$ 23,209,706	\$ 13,618,484	\$ 54,855,642
Liabilities:								
Line of credit	\$ 1,000,000	\$ -	\$ -	\$ 1,000,000	\$ 750,000	\$ -	\$ -	\$ 750,000
Accounts payable and accrued expenses	1,020,226	-	-	1,020,226	800,335	-	-	800,335
Loan payable	123,370	-	-	123,370	-	-	-	-
Deferred revenue	368,274	-	-	368,274	322,646	-	-	322,646
Total liabilities	2,511,870	-	-	2,511,870	1,872,981	-	-	1,872,981
Net assets:								
Unrestricted:								
Undesignated	(207,265)	-	-	(207,265)	568,756	-	-	568,756
Designated for property and equipment	12,973,443	-	-	12,973,443	15,585,715	-	-	15,585,715
Temporarily restricted	-	23,142,081	-	23,142,081	-	23,209,706	-	23,209,706
Permanently restricted	-	-	13,310,051	13,310,051	-	-	13,618,484	13,618,484
Total net assets	12,766,178	23,142,081	13,310,051	49,218,310	16,154,471	23,209,706	13,618,484	52,982,661
	\$ 15,278,048	\$ 23,142,081	\$ 13,310,051	\$ 51,730,180	\$ 18,027,452	\$ 23,209,706	\$ 13,618,484	\$ 54,855,642

The accompanying notes are an integral part of these financials

THE TECH MUSEUM OF INNOVATION

Statement of Activities

Years Ended December 31,

	2004				2003			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	<i>Restated</i>			
					Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Support and revenue:								
Public support	\$ 1,300,000	\$ -	\$ -	\$ 1,300,000	\$ 1,322,750	\$ -	\$ -	\$ 1,322,750
Contributed support and special events, net of allowance and net present value adjustment	4,457,194	1,454,757	(144,112)	5,767,839	4,648,773	935,701	1,018,437	6,602,911
Donated property, services and rent	760,897	1,327,779	-	2,088,676	738,668	1,332,094	-	2,070,762
Admissions and fees	3,404,110	-	-	3,404,110	3,006,719	-	-	3,006,719
Store revenue	712,979	-	-	712,979	762,147	-	-	762,147
Federal awards	815,041	-	-	815,041	886,995	-	-	886,995
Interest income	291,175	-	-	291,175	327,158	-	-	327,158
Realized/unrealized gains (losses) on investments, net	1,163,163	-	-	1,163,163	926,170	-	-	926,170
Net assets released from restriction	3,014,482	(2,850,161)	(164,321)	-	3,678,624	(3,842,498)	163,874	-
Total support and revenue	15,919,041	(67,625)	(308,433)	15,542,983	16,298,004	(1,574,703)	1,182,311	15,905,612
Expenses:								
Program services:								
Exhibits, programs, and experiences	10,961,389	-	-	10,961,389	10,564,691	-	-	10,564,691
Visitor services	1,789,799	-	-	1,789,799	2,211,223	-	-	2,211,223
Education	932,425	-	-	932,425	1,343,851	-	-	1,343,851
Supporting services:								
Fundraising and special events	2,073,574	-	-	2,073,574	1,936,729	-	-	1,936,729
Membership	240,920	-	-	240,920	319,301	-	-	319,301
Management and general:								
Marketing and public relations	1,123,274	-	-	1,123,274	1,013,961	-	-	1,013,961
Administration	1,275,566	-	-	1,275,566	1,149,521	-	-	1,149,521
Loss on disposal of assets	910,385	-	-	910,385	120,500	-	-	120,500
Total expenses	19,307,334	-	-	19,307,334	18,659,777	-	-	18,659,777

THE TECH MUSEUM OF INNOVATION

Statement of Cash Flows

Increase (Decrease) in Cash and Cash Equivalents

	<u>Years Ended December 31,</u>	
	<u>2004</u>	<u>2003</u>
		<u>Restated</u>
Cash flows from operating activities:		
Change in net assets	\$ (3,764,351)	\$ (2,754,165)
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation	4,701,329	5,188,229
Loss on disposal of assets	910,385	120,500
Provision for estimated uncollectible contributed support	(22,101)	(88,808)
Present value adjustment, net	(161,478)	(107,985)
Donated equipment	(553,446)	(470,527)
Contributions restricted for investment in endowment	308,433	(1,182,311)
Realized and unrealized (gain) loss on investments	(1,163,163)	(926,170)
Changes in operating assets and liabilities:		
Support receivables	1,181,306	1,070,005
Grants receivable	124,699	(92,140)
Other receivable	(92,135)	(272,333)
Prepaid expenses and other assets	308,585	260,557
Inventory	(22,377)	96,689
Accounts payable and accrued expenses	219,891	(571,220)
Deferred revenue	45,628	85,601
Net cash provided by operating activities	<u>2,021,205</u>	<u>355,922</u>
Cash flows from investing activities:		
Purchases of property and equipment	(2,429,813)	(1,154,531)
Proceeds from sales / purchases of investments, net	<u>(133,247)</u>	<u>(1,548,846)</u>
Net cash used in investing activities	<u>(2,563,060)</u>	<u>(2,703,377)</u>
Cash flows from financing activities:		
Net (release) contributions for investment in endowment	(308,433)	1,182,311
Proceeds from line of credit	1,800,000	750,000
Payment on line of credit	(1,550,000)	-
Proceeds from loan payable	183,753	-
Payments on loan payable	<u>(60,383)</u>	<u>(140,000)</u>
Net cash provided by financing activities	<u>64,937</u>	<u>1,792,311</u>
Net decrease in cash and cash equivalents	(476,918)	(555,144)
Cash and cash equivalents, beginning of year	<u>1,858,507</u>	<u>2,413,651</u>
Cash and cash equivalents, end of year	<u>\$ 1,381,589</u>	<u>\$ 1,858,507</u>

The accompanying notes are an integral part of these financials

THE TECH MUSUEM OF INNOVATION

Notes to Financial Statements

December 31, 2004

Note 1 - Organization and operations:

The Tech Museum of Innovation (the "Tech") was incorporated on January 11, 1983 as a nonprofit public benefit corporation. The purpose of the Tech is to operate a world-class technology science museum. The Tech's support and revenue comes primarily through contributions, admissions, and fees, federal awards, and store revenue.

The Tech Museum of Innovation is an educational resource established to engage people of all ages and backgrounds in exploring and experiencing the technologies affecting their lives, and to inspire young people to become innovators in the technologies of tomorrow.

The Tech has been classified as a publicly supported, tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code, and is exempt from California franchise taxes under Revenue and Taxation Code Section 23701(d).

Note 2 - Summary of significant accounting policies:

Basis of accounting - The financial statements have been prepared on the accrual basis of accounting and accordingly reflect all significant receivables, payables, and other liabilities.

Basis of presentation - Financial statement presentation follows the recommendations of the Financial Accounting Standards Board in its Statement of Financial Accounting Standards (SFAS) No. 117, *Financial Statements of Not-for-Profit Organizations*. Under SFAS No. 117, the Organization is required to report information regarding its financial position and activities according to three classes of net assets:

- ◆ *Unrestricted net assets* are available to support all activities of The Tech without restrictions.
- ◆ *Temporarily restricted net assets* represent contributions whose use is limited to donor-imposed stipulations that expire by the passage of time or other restrictions and for which the applicable restriction was not met as of the end of the current reporting period.
- ◆ *Permanently restricted net assets* are restricted by the donor for investment in perpetuity, such as endowments. As determined by The Tech, the income from such invested assets, including realized and unrealized capital gains, is available to support the activities of The Tech at a rate of 5% of the total invested assets in the endowment, applied on a quarterly basis, as long as the market value of the invested assets is the same as, or greater than, the original investment value.

THE TECH MUSUEM OF INNOVATION

Notes to Financial Statements

December 31, 2004

Note 2 - Summary of significant accounting policies (continued):

Use of estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Cash and cash equivalents - The Tech considers all highly liquid debt instruments purchased with a maturity of 3 months or less to be cash equivalents. Interest incurred was \$35,146 and \$3,577 as of December 31, 2004 and 2003, respectively.

Investments - The Tech invests in marketable securities consisting of corporate bonds, equity securities, treasury bonds and money market funds. Investments are recorded at estimated fair value at the date of donation. Gains and losses that result from market fluctuations are recognized in the period such fluctuations occur. Dividend and interest income are accrued when earned.

Inventory - Inventory consists principally of merchandise sold in the Tech store and is stated at the lower of cost or market on a first-in/first-out ("FIFO") basis.

Prepaid expenses and other assets - Prepaid expenses and other assets include payments on a 10-year lease commitment for the IMAX theatre prepaid in 1998 with a remaining balance of approximately \$848,000 (see Note 13).

Contributed support receivable - Contributed support receivable is predominantly associated with pledges for The Tech's endowment. Pledges that are expected to be collected after one year have been discounted at 6.00%. An allowance reserve for uncollectible pledges has been established utilizing a 2% factor. The financial statements reflect these pledges net of the discount and allowance reserve.

Property and equipment - Purchased property and equipment are stated at cost. Acquisition of property and equipment in excess of \$3,000 are capitalized. Significant donated property and equipment is recorded at estimated fair value at the date of receipt. Depreciation is computed using the straight-line method over the estimated useful lives of the assets ranging from three to seven years. Leasehold improvements are amortized using the straight-line method over the lesser of the assets' estimated useful lives or the term of the applicable lease.

THE TECH MUSUEM OF INNOVATION

Notes to Financial Statements

December 31, 2004

Note 2 - Summary of significant accounting policies (continued):

Contributions-in-kind - Contributions-in-kind are recognized in accordance with SFAS 116. Significant donated property and equipment is recorded at estimated fair value at the date of receipt. Contributed services, which require a specialized skill and which The Tech would have paid for if not contributed, have been recorded at their estimated fair market value. In addition, a substantial number of volunteers have donated significant amounts of time in The Tech's program services and fund-raising activities. The value of donated volunteer services has not been recognized in the accompanying financial statements because such volunteer services do not require specialized skills.

Revenue recognition - Contributed support that is restricted by the donor is reported as an increase in unrestricted net assets if the restriction expires in the reporting period in which the support is recognized. All other contributed support is recognized as revenue when received or un-conditionally promised. The Tech reports gifts of cash and other assets as restricted support if such gifts are received with donor stipulations that limit the use of the donated assets. When such restrictions expire, that is, when a stipulated time restriction ends or a purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported as net assets released from restrictions.

Membership dues are deferred upon receipt and recognized as revenue ratably over the membership period, generally for the one-year period effective as of the month of receipt.

Federal awards - Federal awards consist of funds received from the federal government for specific research projects. Substantially all of the Tech's federal award revenue is derived from cost reimbursement grants, which are billed to the grantor after costs have been incurred. Federal award revenue and unbilled federal awards are recognized to the extent the related costs are incurred.

Federal awards are subject to review and audit by the grantor agencies in accordance with the Single Audit Act and Office of Management and Budget (OMB) Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations". Although such audits could result in expenditure disallowances under terms of the grants, it is believed that any required reimbursement would not be material.

Functional expense allocations - The costs of providing the various program and supporting services have been summarized on a functional basis in the statement of activities and changes in net assets. Accordingly, certain costs have been allocated, principally on a direct cost basis, among the classifications.

THE TECH MUSUEM OF INNOVATION

Notes to Financial Statements

December 31, 2004

Note 2 - Summary of significant accounting policies (continued):

Joint costs - The organization conducts activities that included requests for contributions, as well as program and management and general components. For 2004, those activities included special events and a golf tournament. The costs of these activities are accounted for as fundraising costs.

Concentration of credit risk - Financial instruments that potentially subject The Tech to credit risk consist primarily of cash, cash equivalents, investments, and contributed support receivable.

The Tech maintains cash and cash equivalents with commercial banks and other major financial institutions. Cash equivalents include overnight investments, bonds with maturities of 90 days or less, and money market funds. At times, such amounts might exceed FDIC limits. The Tech's investments have been placed with high quality financial institutions. The Tech closely monitors these investments and has not experienced significant credit losses.

The credit risk in contributed support receivable is mitigated by the fact that generally the pledges are made by local donors and are evaluated by The Tech based on the knowledge of the donors. Additionally, any contributed services receivable that are expected to be collected after one year have been discounted and are reflected in the financial statements at their net present value. It is The Tech's opinion that it is not exposed to any significant credit risks.

Advertising - Advertising costs are expensed as incurred. Advertising, promotion, and marketing expense for the years ended December 31, 2004 and 2003 were approximately \$1,155,000 and \$1,118,000, respectively.

Note 3 - Investments:

The Tech's investments consisted of the following:

	December 31,	
	2004	2003
Corporate bonds and notes	\$ 1,467,988	\$ 1,221,713
Money market funds	711,934	1,088,715
Equity funds	7,998,833	6,515,673
Venture capital funds	381,532	244,784
U.S. Treasury bonds and notes	1,525,467	1,718,459
Total	\$ 12,085,754	\$ 10,789,344

THE TECH MUSUEM OF INNOVATION

Notes to Financial Statements

December 31, 2004

Note 3 - Investments (continued):

The following schedule summarizes the investment returns for the year ended:

	<u>December 31,</u>	
	<u>2004</u>	<u>2003</u>
Dividend and interest income	\$ 291,175	\$ 327,158
Net realized / unrealized gains (losses)	1,163,163	926,170
Total	<u>\$ 1,454,338</u>	<u>\$ 1,253,328</u>

Note 4 - Contributed support receivable:

Contributed support receivables are recorded after discounting the future cash flows to present value using a discount rate of 6%. The maturities of these receivables are as follows:

Years Ending December 31,	<u>Contributed Support</u>	<u>Contributed Use of</u>
2005	\$ 1,218,652	\$ 1,404,000
2006	154,323	1,404,000
2007	35,000	1,404,000
2008	25,000	1,404,000
2009	-	1,404,000
Thereafter	-	61,776,000
	<u>1,432,975</u>	<u>68,796,000</u>
Less discount for present value	(96,767)	(46,742,568)
Less allowance for estimated uncollectible contributed support	<u>(28,660)</u>	<u>-</u>
Total	<u>\$ 1,307,548</u>	<u>\$ 22,053,432</u>

The Tech has entered into an agreement with the City of San Jose (the "City") for the lease of its primary facility for \$1 a year. The receivable for the contributed use of the facility reflects the fair value of the use of the facility for 49 years (through 2053). With the adoption of the provisions of the *1996 AICPA Audit and Accounting Guide for Not-for-Profit Organizations*, The Tech recognized contribution revenue and a receivable for the present value of the promise for rent-free use of the facility with the annual maturity of contributed support receivable recognized as rent expense.

THE TECH MUSUEM OF INNOVATION

Notes to Financial Statements

December 31, 2004

Note 5 - Property and equipment:

Property and equipment consisted of the following:

	December 31,	
	2004	2003
Leasehold improvements	\$ 10,236,637	\$ 10,225,578
Furniture, fixtures and improvements	8,685,312	8,191,599
Exhibits	22,606,213	26,405,104
Construction in Progress	11,963	679,996
Total	41,540,125	45,502,277
Less: accumulated depreciation and amortization	(28,566,682)	(29,916,562)
Property and equipment, net	\$ 12,973,443	\$ 15,585,715

Depreciation expense for the years ended December 31, 2004 and 2003 was \$4,701,329 and \$5,188,229, respectively.

Note 6 - Temporarily restricted net assets:

Temporarily restricted net assets were available for the following purposes as of:

	December 31,	
	2004	2003
Use of facilities	\$ 22,053,431	\$ 22,129,652
Special Projects	724,960	737,239
Campaign support receivable	-	138,509
Educational programs	288,690	143,390
Operations	75,000	60,916
Total temporarily restricted net assets	\$ 23,142,081	\$ 23,209,706

THE TECH MUSUEM OF INNOVATION

Notes to Financial Statements

December 31, 2004

Note 7 - Temporarily restricted net assets released from restrictions:

Net assets were released from restrictions by incurring expenses satisfying the restricted purposes during the year as follows:

	December 31,	
	2004	2003
Use of facilities	\$ 1,404,000	\$ 1,404,000
Educational programs	328,256	1,247,039
Special Projects	1,061,989	739,361
Operations	55,916	452,098
Total temporarily restricted net assets	<u>\$ 2,850,161</u>	<u>\$ 3,842,498</u>

Note 8 - Permanently restricted net assets:

Permanently restricted net assets consist of endowment fund investments that represent the principle amounts of gifts and bequests accepted with donor stipulation that the principal be maintained intact in perpetuity, with only the income to be utilized for operations.

The decrease in permanently restricted net assets during the year is as follows:

Restricted pledges received	\$ 22,952
2003 earnings greater than 5% reclassified to the 2004 budget	(160,521)
Pledges deemed uncollectible and present value adjustment	(167,064)
Other	<u>(3,810)</u>
Change in permanently restricted net assets	<u>\$ (308,433)</u>

As discussed at Note 2, the Board had determined that 5% of the earnings on permanently restricted net assets are to be used to support the activities of The Tech. In December 2004, the Board resolved to apply the full amount of the 2003 and 2004 earnings to the 2004 operating budget.

THE TECH MUSUEM OF INNOVATION

Notes to Financial Statements

December 31, 2004

Note 9 - Related party transactions:

The Tech's volunteer members of the Board of Directors are active in oversight of fundraising events, activities and in making private contributions. Contributions received from the Board of Directors or from companies with which the Board of Directors are affiliated were approximately \$2,080,758 and \$2,502,708 for the years ended December 31, 2004 and 2003, respectively.

Of the total Contributed support receivable, net, receivables from the Board of Directors or from companies with which the Board of Directors are affiliated were approximately \$1,038,639 and \$1,467,581 for the years ended December 31, 2004 and 2003, respectively.

The Tech has a less than 10% investment in a partnership in which one of the members of the Board of Directors is an owner. The fair value of this investment was \$381,532 and \$244,784 for the years ended December 31, 2004 and 2003, respectively.

Note 10 - Loan payable:

Loan payable represents a financing arrangement with Premium Financing Specialists of California, Inc. for the Organization's insurance premiums. The loan bears an interest rate of 5.697% and requires monthly payments of approximately \$21,000. At December 31, 2004, future minimum payments of \$123,370 are scheduled for 2005.

Note 11 - Line of credit:

The Tech has a line of credit agreement, expiring October 1, 2005, with Bank of America. Borrowings under the agreement bear interest at the bank's prime rate (5.25% as of December 31, 2004). At December 31, 2004 and 2003, the outstanding balance was \$1,000,000 and \$750,000, respectively.

Note 12 - Major contributions:

In 2004, ten donors accounted for 50% of contributed support. In 2003, ten donors accounted for 43% of contributed support.

THE TECH MUSUEM OF INNOVATION

Notes to Financial Statements

December 31, 2004

Note 13 - Commitments:

The Tech is obligated under non-cancelable operating leases for office, storage space and exhibits, which expire in January 2005 through September 2007.

The schedule of future minimum lease payments payable under its non-cancelable leases is as follows:

<u>Years Ending December 31,</u>		
2005	\$	516,129
2006		81,463
2007		<u>61,097</u>
	\$	<u>658,689</u>

Rental expense under the above leases was approximately \$367,000 and \$430,000 for the years ended December 31, 2004 and 2003, respectively.

The Tech has a 10-year lease commitment for the IMAX Theater, and elected to prepay the minimum lease value in 1998. The Tech will amortize this prepayment over the term of the lease and recognize lease expense of \$236,800, annually, through 2008. The Tech is subject to additional rent payments based on 7% of annual gross revenues over \$2,000,000 from the IMAX Theater. The Tech did not pay any additional rent for 2004 or 2003.

Included in the commitments above is a maintenance agreement related to the IMAX theater equipment lease, which requires a minimum of approximately \$81,000 in maintenance each year, adjusted quarterly by the consumer price index, over the term of the 10-year lease.

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Notes to Financial Statements

December 31, 2004

Note 14 - Retirement plan:

The Tech provides a defined contribution plan for all full-time employees. The plan provides for employee contributions plus employer contributions at The Tech's discretion. The Tech did not make any contributions for 2004 or 2003.

In 1999, The Tech initiated a Key Employee Option Plan whereby selected employees enter into pre-tax compensation reduction option agreements with The Tech concurrent with being awarded non-qualified options to purchase shares in a fund. The number of non-qualified options granted is based on actual compensation reduction amounts assuming a 25% discount from fair market value to be paid upon exercise. The fund is comprised of two mutual funds and had a fair value of \$118,376 and \$151,505 at December 31, 2004 and 2003, respectively. The fund was created with the monies contributed by The Tech and employees as specified in their respective compensation reduction option agreements.

Employees may exercise their options on or after the first January 1 following the first anniversary of their compensation reduction option agreement. The exercise price per share of the shares to be purchased is 25% of the lesser of the Exercise Rate Fair Market Value or the Grant Date Fair Market Value increased by 7% per year from the grant date, compounded annually. The fair market value shall be based on prices reported on an established recognized stock exchange, unless the shares are not publicly traded, in which case it shall be determined by the Executive Committee of the Board of Directors of The Tech. At December 31, 2004, The Tech had awarded options to four employees, all of which were exercisable. During 2004, one employee exercised previously awarded options. Included in accrued liabilities at December 31, 2004 and 2003 is \$88,782 and \$113,629, respectively, associated with this plan. As of December 31, 2004, participation in the plan has been frozen.

Note 15 - Change in accounting estimate

During 2004, The Tech changed its estimates of the useful lives of certain exhibit-related assets. The depreciable lives of these assets, previously estimated at seven years, were decreased to five years. The Tech made these changes to better reflect the estimated periods during which such assets will remain in service. This change had an immaterial effect on the statement of activities for 2004.

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Notes to Financial Statements

December 31, 2004

Note 16 - Prior-period adjustment

The Organization has restated its previously issued 2003 financial statements for matters related to the capitalization of labor costs and fringe benefits associated with newly constructed exhibit-related assets. The accompanying financial statements for 2003 have been restated to reflect the corrections. The impact of this adjustment was an increase in net assets of \$591,762.

The following is a summary of the restatements for 2003:

Increase in previously reported exhibits, programs and experiences	\$	<u>591,762</u>
Total increase in net assets	\$	<u>591,762</u>

The effect on the Organization's previously issued 2003 financial statements are summarized as follows:

	<u>Previously reported</u>	<u>Increase (decrease)</u>	<u>Restated amount</u>
Exhibits, programs and experiences	\$ 11,156,453	(591,762)	10,564,691
Total expenses	\$ 19,251,539	(591,762)	18,659,777
Change in net assets	\$ (3,345,927)	591,762	(2,754,165)
Net assets at end of year	\$ 52,390,899	591,762	52,982,661
Property and equipment, net	\$ 14,993,953	591,762	15,585,715
Total net assets	\$ 54,263,880	591,762	54,855,642

ADDITIONAL AUDITORS' REPORTS

**REPORT ON INTERNAL CONTROL AND COMPLIANCE OVER FINANCIAL
REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

Board of Directors
The Tech Museum of Innovation

We have audited the financial statements of The Tech Museum of Innovation (a nonprofit organization) as of and for the year ended December 31, 2004, and have issued our report thereon dated January 21, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether The Tech Museum of Innovation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered The Tech Museum of Innovation's internal control over financial reporting 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 over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting, which we have reported to management of The Tech Museum of Innovation in a separate letter dated January 21, 2005.

This report is intended solely for the information and use of the audit committee, management, others within the organization and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink, reading "Leland San Filippo". The signature is written in a cursive style with a large initial 'L' and a long, sweeping tail.

San Jose, California
January 21, 2005

**REPORT ON COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL
OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

Board of Directors
The Tech Museum of Innovation

Compliance

We have audited the compliance of The Tech Museum of Innovation (a nonprofit organization) with the types of compliance requirements described in the "U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement" that are applicable to each of its major federal programs for the year ended December 31, 2004. The Tech Museum of Innovation's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of The Tech Museum of Innovation's management. Our responsibility is to express an opinion on The Tech Museum of Innovation's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about The Tech Museum of Innovation's compliance with those requirements and performing such other procedures, as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of The Tech Museum of Innovation's compliance with those requirements.

In our opinion, The Tech Museum of Innovation complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended December 31, 2004.

Internal Control Over Compliance

The management of The Tech Museum of Innovation is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered The Tech Museum of Innovation's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the audit committee, management, others within the organization and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in cursive script, reading "Leland San Felipe".

San Jose, California
January 21, 2005

**THE TECH MUSEUM OF INNOVATION
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
DECEMBER 31, 2004**

Federal Grantor/ Program Title	Federal CFDA Number	Grantor's Number	Program Award Amount	Federal Program Revenue	Federal Program Expenditures	Matching Expenditures
U.S. DEPARTMENT OF HEALTH & HUMAN SERVICES						
Passed through National Institute of Health						
Life's New Frontier: Public Health Genetics Phase I/II	93.333	R5RR17381A	\$332,484	\$172,637	\$142,668	\$942,142
U.S DEPARTMENT OF EDUCATION AND HUMAN RESOURCES						
Passed through National Science Foundation						
Build Your Internet: An Exhibition to Foster Public Understanding and Participation	47.076	ESI-0206399	180,897	642,404	625,533	803,651
			\$513,381	\$815,041	\$768,201	\$1,745,793

THE TECH MUSEUM OF INNOVATION
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED DECEMBER 31, 2004

Section I—Summary of Auditor's Results

Financial Statements

Type of auditor's report issued: unqualified

Internal control over financial reporting:
Material weakness(es) identified? _____ yes X no
Reportable condition(s) identified that are
not considered to be material weakness(es)? _____ yes X none reported

Noncompliance material to financial statements
noted? _____ yes X no

Federal Awards

Internal control over major programs:
Material weakness(es) identified? _____ yes X no
Reportable condition(s) identified that are
not considered to be material weakness(es)? _____ yes X none reported

Type of auditor's report issued on compliance
for major programs: unqualified

Any audit findings disclosed that are required
to be reported in accordance with section
510(a) of Circular A-133? _____ yes X no

Identification of major programs:

CFDA Number(s) Name of Federal Program or Cluster

47.076 Build Your Internet: An Exhibition to Foster Public Understanding and
Participation

Dollar threshold used to distinguish
between type A and type B programs? \$300,000

Auditee qualified as low-risk auditee? _____ yes X no

THE TECH MUSEUM OF INNOVATION
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
YEAR ENDED DECEMBER 31, 2004

Section II—Financial Statement Findings

None

Section III—Federal Award Findings and Questioned Costs

None

THE TECH MUSEUM OF INNOVATION
STATUS OF PRIOR YEAR'S (2003) FINDINGS AND QUESTIONED COSTS
AS OF DECEMBER 31, 2004

2003-1 Finding

Per review of the entities expenditures for the year, the following was noted: 1) the supporting detail of expenditures did not agree to the ledger; 2) timesheets for employees working on the grant were not complete; 3) receipts for an expenditure claimed was missing.

Questioned Costs

Authorized and allowable amount not claimed for reimbursement	\$(3,619)
Expenditures claimed for labor where timesheets were missing	25,458
Expenditures claimed for labor where grant allocation on timesheet were not documented	6,750
Expenditure claimed where supporting documentation could not be located	<u>35</u>
	<u>\$28,624</u>

Recommendation

It is recommend the entity reconcile the supporting documentation to its general ledger and to the amounts claimed for reimbursement. The entity also needs to implement additional controls over timekeeping for time spent on federally awarded programs. This would include requiring timecards of *all* employees, even if non-exempt. When the timecard is signed by the employee's supervisor and received by human resources department, it should be checked for completeness. If information is missing or incomplete, it should go back to the employee to correct and complete as needed. Prior to posting expenditures to any federal awards, the entity needs to make sure all expenditures, are supported by receipts. If they are not, then there should be no allocation for that amount to the award until the receipt is available.

Management Response

The timekeeping procedures have been modified to ensure accuracy in project charging and physical control over timesheets. Additionally, all expenditures associated with federal awards, no matter how small, will require a receipt prior to reimbursement.

Current Status

For fiscal year 2004 expenditures, (1) supporting detail and general ledger accounts reconcile; (2) timesheets for employees working on the grant are complete; and (3) receipts were received for all expenditures associated with the federal awards, no matter how small.

THE TECH MUSEUM OF INNOVATION
STATUS OF PRIOR YEAR'S (2003) FINDINGS AND QUESTIONED COSTS (Continued)
AS OF DECEMBER 31, 2004

2003-2 Finding

During our work in the fixed assets section, it was noted the organization has not conducted a physical inventory of their fixed assets. In addition, assets purchased with federal funds were not segregated and identified.

Questioned Costs

None

Recommendation

The Organization should inventory its fixed assets every couple of years. In addition, when using federal funds to purchase items over \$5,000, these assets should be separately identifiable. This listing can be maintained in a separate program or worksheet, which ties into the organization asset listing, and should contain the following information about the equipment: description, (including serial number or other identification number), source, who holds title, acquisition date and cost including, the date of disposal and sales price or method used to determine current fair market value.

Management Response

A physical inventory of fixed assets will be conducted during 2004 and reconciled to the general ledger. Additionally, a separate fixed asset ledger will be created specifically for assets purchased with federal funds, with all pertinent information contained therein.

Status

A physical inventory of fixed assets was performed in August and reconciled to the general ledger. Additionally, a subsidiary fixed asset ledger was created that separately identifies all components of assets purchased with federal funds. This subsidiary fixed asset ledger contains pertinent information such as a description, date of acquisition and cost of acquisition.

THE TECH MUSEUM OF INNOVATION
STATUS OF PRIOR YEAR'S (2003) FINDINGS AND QUESTIONED COSTS (Continued)
AS OF DECEMBER 31, 2004

2003-3 Finding

Per inquiry, it was noted the organization does not appear to have written procurement procedures as required per Office of Management and Budget (OMB) Circular A-110 Sections 44.

Questioned Costs

None

Recommendation

Per OMB A-110, sections 40 through 48, establish procedures for the procurement of supplies and other expendable property, equipment, real property and other services with Federal funds. The organization should establish written procurement procedures, which shall provide for, at a minimum, the following per Section 44:

- 1) recipients avoid purchasing unnecessary items
- 2) where appropriate, an analysis is made of lease and purchase alternatives to determine which would be the most economical and practical procurement for the Federal Government
- 3) solicitation for goods and services provide for all of the following:
 - i. a clear and accurate description of the technical requirements for the material, product or service to be procured. In competitive procurements, such a description shall not contain features, which unduly restrict competition
 - ii. requirements which the bidder/offerer must fulfill and all other factors to be used in evaluating bids or proposals
 - iii. a description, whenever practicable, of technical requirements in terms of functions to be performed or performance required, including the range of acceptable characteristics or minimum acceptable standards
 - iv. the specific features of "brand name or equal" descriptions that bidders are required to meet when such items are included in the solicitation
 - v. the acceptance, to the extent practicable and economically feasible, of products and services dimensioned in the metric system of measurement and
 - vi. preference, to the extent practicable and economically feasible, for products and services that conserve natural resources and protect the environment and are energy efficient

Management Response

The Tech's procurement procedures will be updated to incorporate the procurement of supplies and other expendable property, equipment, real property and other service with Federal funds as outlined in OMB A-110, Sections 40 through 48.

**THE TECH MUSEUM OF INNOVATION
STATUS OF PRIOR YEAR'S (2003) FINDINGS AND QUESTIONED COSTS (Continued)
AS OF DECEMBER 31, 2004**

2003-3 (Continued)

Status

A written procurement (purchasing) policy has been established that describes procedures for the procurement of supplies and other expandable property, equipment, real property and other services with Federal funds.

2003-4 Finding

Per review of the organizations files for federal awards it was noted documentation, such as a grant award letter and a fully executed grant agreement, was missing.

Questioned Costs

None

Recommendation

When the organization receives federal awards, it should make sure their files contain all the appropriate documentation and, at a minimum, the award letter and agreement. If this documentation is not available from the granting agency, the organization should take measures to ensure they fully understand the compliance requirements and how and where the funds may be used. If the award is vague, further understanding should be obtained to ensure the organization spends the award on authorized and allowable expenditures and complies with all aspects of the award so as not to jeopardize future federal funding.

Management Response

Upon federal grant award, and prior to commencement of activities, the Development Department will ensure that all appropriate documentation, including, at a minimum, the award letter and agreement specifying compliance requirements, will be contained in the master program file.

Status

For federal awards received in 2004, all appropriate documentation was obtained, including compliance requirements.