

THE TECH MUSEUM OF INNOVATION

**Financial Statements
December 31, 2003 and 2002**

**Together with
Independent Auditors' Report**

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of the
The Tech Museum of Innovation

We have audited the accompanying statement of financial position of The Tech Museum of Innovation (the "Organization") as of December 31, 2003, and the related statement of activities and changes in net assets and of cash flows for the year 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 audit. The financial statements of The Tech Museum of Innovation as of December 31, 2002, were audited by other auditors whose report dated April 25, 2003, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit 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 audit provides a reasonable basis for our opinion.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated April 28, 2004, 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 audit.

Our audit was 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.

San Jose, California
April 28, 2004



THE TECH MUSEUM OF INNOVATION

Statement of Financial Position

	December 31, 2003				December 31, 2002			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
ASSETS								
Cash and cash equivalents	\$ 104,113	\$ 864,295	\$ 890,099	\$ 1,858,507	\$ 44,203	\$ 982,038	\$ 1,387,410	\$ 2,413,651
Investments	151,505	-	10,637,839	10,789,344	237,411	-	8,076,917	8,314,328
Grants receivable, net	128,891	-	-	128,891	36,751	-	-	36,751
Other receivable	465,316	75,000	-	540,316	267,983	-	-	267,983
Inventory	196,189	-	-	196,189	292,878	-	-	292,878
Prepaid expenses and other assets	1,395,723	2,250	-	1,397,973	1,658,530	-	-	1,658,530
Contributed support receivable, net	-	138,509	2,090,546	2,229,055	-	586,450	2,443,910	3,030,360
Receivable for contributed use of facility, net	-	22,129,652	-	22,129,652	-	22,201,559	-	22,201,559
Property and equipment, net	14,993,953	-	-	14,993,953	19,269,386	-	-	19,269,386
	<u>\$ 17,435,690</u>	<u>\$ 23,209,706</u>	<u>\$ 13,618,484</u>	<u>\$ 54,263,880</u>	<u>\$ 21,807,142</u>	<u>\$ 23,770,047</u>	<u>\$ 11,908,237</u>	<u>\$ 57,485,426</u>
LIABILITIES AND NET ASSETS								
Liabilities:								
Accounts payable and accrued expenses	\$ 814,010	\$ -	\$ -	\$ 814,010	\$ 1,385,230	\$ -	\$ -	\$ 1,385,230
Payable (receivable) between net asset categories	-	-	-	-	1,542,298	(1,014,362)	(527,936)	-
Deferred revenue	308,971	-	-	308,971	223,370	-	-	223,370
Note payable	750,000	-	-	750,000	140,000	-	-	140,000
Total liabilities	<u>1,872,981</u>	<u>-</u>	<u>-</u>	<u>1,872,981</u>	<u>3,290,898</u>	<u>(1,014,362)</u>	<u>(527,936)</u>	<u>1,748,600</u>
Net assets:								
Unrestricted:								
Undesignated	568,756	-	-	568,756	(753,142)	-	-	(753,142)
Designated for property and equipment	14,993,953	-	-	14,993,953	19,269,386	-	-	19,269,386
Temporarily restricted	-	23,209,706	-	23,209,706	-	24,784,409	-	24,784,409
Permanently restricted	-	-	13,618,484	13,618,484	-	-	12,436,173	12,436,173

THE TECH MUSEUM OF INNOVATION

Statement of Activities

Years Ended December 31,

	2003				2002			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Support and revenue:								
Public support	\$ 1,322,750	\$ -	\$ -	\$ 1,322,750	\$ 1,549,299	\$ 112,125	\$ -	\$ 1,661,424
Contributed support and special events, net of allowance and net present value adjustment	4,648,773	935,701	1,018,437	6,602,911	3,771,027	1,917,827	465,038	6,153,892
Donated property, services and rent	738,668	1,332,094	-	2,070,762	2,262,785	1,336,164	-	3,598,949
Admissions and fees	3,006,719	-	-	3,006,719	3,591,210	-	-	3,591,210
Store revenue	762,147	-	-	762,147	756,781	-	-	756,781
Federal awards	886,995	-	-	886,995	94,794	-	-	94,794
Interest income	327,158	-	-	327,158	320,529	24,937	-	345,466
Realized/unrealized gains (losses) on investments, net	926,170	-	-	926,170	(604,725)	-	-	(604,725)
Net assets released from restriction	3,678,624	(3,842,498)	163,874	-	4,126,063	(3,625,619)	(500,444)	-
Total support and revenue	<u>16,298,004</u>	<u>(1,574,703)</u>	<u>1,182,311</u>	<u>15,905,612</u>	<u>15,867,763</u>	<u>(234,566)</u>	<u>(35,406)</u>	<u>15,597,791</u>
Expenses:								
Program services:								
Exhibits, programs, and experiences	11,156,453	-	-	11,156,453	9,009,509	-	-	9,009,509
Visitor services	2,211,223	-	-	2,211,223	3,285,961	-	-	3,285,961
Education	1,343,851	-	-	1,343,851	1,086,429	-	-	1,086,429
Supporting services:								
Development and special events	2,246,030	-	-	2,246,030	2,543,405	-	-	2,543,405
Management and general:								
Marketing and public relations	1,023,961	-	-	1,023,961	2,585,330	-	-	2,585,330
Administration	1,149,521	-	-	1,149,521	2,628,460	-	-	2,628,460
Other expense	120,500	-	-	120,500	-	-	-	-
Total expenses	<u>19,251,539</u>	<u>-</u>	<u>-</u>	<u>19,251,539</u>	<u>21,139,094</u>	<u>-</u>	<u>-</u>	<u>21,139,094</u>
Change in net assets	(2,953,535)	(1,574,703)	1,182,311	(3,345,927)	(5,271,331)	(234,566)	(35,406)	(5,541,303)

THE TECH MUSEUM OF INNOVATION

Statement of Cash Flows

Increase (Decrease) in Cash and Cash Equivalents

	Years Ended December 31,	
	2003	2002
Cash flows from operating activities:		
Change in net assets	\$ (3,345,927)	\$ (5,541,303)
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation	5,188,229	5,657,848
Loss on disposal of assets	120,500	-
Provision for estimated uncollectible contributed support	(88,808)	(144,410)
Present value adjustment, net	(107,985)	(187,742)
Donated equipment	(470,527)	(1,003,949)
Donated investments	-	(705,577)
Contributions restricted for investment in endowment	(1,182,311)	35,406
Realized and unrealized (gain) loss on investments	(926,170)	604,725
Changes in operating assets and liabilities:		
Support receivables	1,070,005	1,468,470
Grants receivable	(92,140)	(36,751)
Other receivable	(272,333)	62,744
Prepaid expenses and other assets	260,557	223,959
Inventory	96,689	(24,803)
Accounts payable and accrued expenses	(571,220)	292,266
Deferred revenue	85,601	(79,246)
Net cash provided by (used in) operating activities	<u>(235,840)</u>	<u>621,637</u>
Cash flows from investing activities:		
Purchases of property and equipment	(562,769)	(793,761)
Proceeds from sales / Purchases of investments, net	<u>(1,548,846)</u>	<u>236,849</u>
Net cash used in investing activities	<u>(2,111,615)</u>	<u>(556,912)</u>
Cash flows from financing activities:		
Net (release) contributions for investment in endowment	1,182,311	(35,406)
Proceeds from line of credit	750,000	-
Payment on notes payable	<u>(140,000)</u>	<u>(140,000)</u>
Net cash provided by (used in) financing activities	<u>1,792,311</u>	<u>(175,406)</u>
Net decrease in cash and cash equivalents	(555,144)	(110,681)
Cash and cash equivalents, beginning of year	<u>2,413,651</u>	<u>2,524,332</u>
Cash and cash equivalents, end of year	<u>\$ 1,858,507</u>	<u>\$ 2,413,651</u>

The accompanying notes are an integral part of these financials

THE TECH MUSUEM OF INNOVATION

Notes to Financial Statements

December 31, 2003

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 presentation - The financial statements are presented on the basis of unrestricted, temporarily restricted and permanently restricted 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. 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.

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.

THE TECH MUSUEM OF INNOVATION

Notes to Financial Statements

December 31, 2003

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

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 \$3,577 and \$10,660 as of December 31, 2003 and 2002, 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.

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.

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.

THE TECH MUSUEM OF INNOVATION

Notes to Financial Statements

December 31, 2003

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

Revenue recognition - Contributed support is recognized as revenue when received or unconditionally 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.

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 TECH MUSUEM OF INNOVATION

Notes to Financial Statements

December 31, 2003

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

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 expense for the years ended December 31, 2003 and 2002 were approximately \$1,118,000 and \$1,015,000, respectively.

Note 3 - Investments:

The Tech's investments consisted of the following:

	December 31,	
	2003	2002
Corporate bonds and notes	\$ 1,221,713	\$ 756,981
Money market funds	1,088,715	5,688,388
Equity funds	6,515,673	1,729,018
Venture capital funds	244,784	139,941
U.S. Treasury bonds and notes	1,718,459	-
Total	\$ 10,789,344	\$ 8,314,328

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

	December 31,	
	2003	2002
Dividend and interest income	\$ 327,158	\$ 345,466
Net realized / unrealized gains (losses)	926,170	(604,725)
Total	\$ 1,253,328	\$ (259,259)

THE TECH MUSUEM OF INNOVATION

Notes to Financial Statements

December 31, 2003

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,	Contributed Support	Contributed Use of Facility
2004	\$ 1,063,964	\$ 1,404,000
2005	798,130	1,404,000
2006	622,443	1,404,000
2007	53,524	1,404,000
2008	-	1,404,000
Thereafter	-	58,369,600
	<u>2,538,061</u>	<u>65,389,600</u>
Less discount for present value	(258,245)	(43,259,948)
Less allowance for estimated uncollectible contributed support	<u>(50,761)</u>	<u>-</u>
Total	<u>\$ 2,229,055</u>	<u>\$ 22,129,652</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 55 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 MUSEUM OF INNOVATION

Notes to Financial Statements

December 31, 2003

Note 5 - Property and equipment:

Property and equipment consisted of the following:

	December 31,	
	2003	2002
Leasehold improvements	\$ 10,225,578	\$ 10,198,736
Furniture, fixtures and improvements	8,191,599	7,763,681
Exhibits	25,813,342	25,483,637
Construction in Progress	679,996	587,666
Total	44,910,515	44,033,720
Less: accumulated depreciation and amortization	(29,916,562)	(24,764,334)
Property and equipment, net	\$ 14,993,953	\$ 19,269,386

Depreciation expense for the years ended December 31, 2003 and 2002 was \$5,188,229 and \$5,657,848, respectively.

Note 6 - Temporarily restricted net assets:

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

	December 31,	
	2003	2002
Use of facilities	\$ 22,129,652	\$ 22,201,559
Special Projects	737,239	478,250
Campaign support receivable	138,509	586,449
Educational programs	143,390	1,155,730
Operations	60,916	362,421
Total temporarily restricted net assets	\$ 23,209,706	24,784,409

THE TECH MUSUEM OF INNOVATION

Notes to Financial Statements

December 31, 2003

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,	
	2003	2002
Use of facilities	\$ 1,404,000	\$ 1,404,000
Educational programs	1,247,039	1,344,250
Special Projects	739,361	819,996
Operations	452,098	57,373
Total temporarily restricted net assets	\$ 3,842,498	\$ 3,625,619

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.

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 \$2,502,708 and \$3,984,907 for the years ended December 31, 2003 and 2002, 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 \$244,784 and \$139,941 for the years ended December 31, 2003 and 2002, respectively.

Note 10 - Line of credit:

The Tech has a line of credit agreement, expiring October 1, 2004, with Bank of America. Borrowings under the agreement bear interest at the bank's prime rate (4.00% as of December 31, 2003). At December 31, 2003, the outstanding balance was \$750,000. There was no outstanding balance at December 31, 2002.

THE TECH MUSUEM OF INNOVATION

Notes to Financial Statements

December 31, 2003

Note 11 - Major contributions:

In 2003, ten donors accounted for 43% of contributed support. In 2002, eleven donors accounted for 72% of contributed support.

Note 12 - Commitments:

The Tech is obligated under non-cancelable operating leases for office, storage space and exhibits, which expire in January 2004 and September 2007, respectively.

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

<u>Years Ending December 31,</u>		
2004	\$	218,560
2005		142,240
2006		82,389
2007		<u>61,792</u>
	\$	<u>504,981</u>

Rental expense under the above leases was approximately \$430,000 and \$429,000 for the years ended December 31, 2003 and 2002, 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 2003 or 2002.

Included in the commitments above is a maintenance agreement related to the IMAX theater equipment lease, which requires a minimum of \$82,389 in maintenance each year over the term of the 10-year lease.

THE TECH MUSUEM OF INNOVATION

Notes to Financial Statements

December 31, 2003

Note 13 - 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 a contribution in 2003 and contributed \$68,393 for 2002.

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 \$151,505 and \$237,411 at December 31, 2003 and 2002, 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, 2003, The Tech had awarded options to four employees, all of which were exercisable. During 2003, another two employees exercised previously awarded options. Included in accrued liabilities at December 31, 2003 and 2002 is \$113,629 and \$178,058, respectively, associated with this plan. As of December 31, 2003, participation in the plan has been frozen.

ADDITIONAL AUDITORS' REPORTS

REPORT ON COMPLIANCE AND ON INTERNAL CONTROL 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, 2003, and have issued our report thereon dated April 28, 2004. 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*. However, we noted certain immaterial instances of noncompliance that we have reported to management of The Tech Museum of Innovation in a separate letter dated May 2, 2004.

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 May 2, 2004.

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, appearing to read "Dulac Santopiero".

San Jose, California
April 28, 2004

**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, 2003. 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, 2003. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 2003-1, 2003-2, 2003-3 and 2003-4.

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, appearing to read "Ingrid San Filippo".

San Jose, California
April 28, 2004

THE TECH MUSEUM OF INNOVATION
 SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
 DECEMBER 31, 2003

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	327,736	\$505,242	\$626,273	\$229,868
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	499,005	252,862	265,855	128,862
U.S DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT						
	N/A	B-03SP-CA-0066	89,415	-	89,415	-
			\$916,156	\$758,104	\$981,543	\$358,730

THE TECH MUSEUM OF INNOVATION
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED DECEMBER 31, 2003

Summary of Auditor's Results

1. The auditor's report expresses an unqualified opinion on the financial statements of The Tech Museum of Innovation.
2. No reportable conditions relating to the audit of the financial statements are reported in the financial statements.
3. No instances of noncompliance material to the financial statements of The Tech Museum of Innovation were disclosed during the audit.
4. No reportable conditions relating to the audit of the major federal award programs are reported in the Single Audit Report.
5. The auditor's report on compliance for the major federal award programs for the Tech Museum of Innovation expresses an unqualified opinion on all major federal programs.
6. Audit findings that are required to be reported in accordance with Section 510(a) of OMB Circular A-133 are reported in this Schedule.
7. The programs tested as major programs include: Life's New Frontier: Public Health Genetics Phase I/II (CFDA No. 93.333).
8. The threshold used for distinguishing between Type A and B programs was \$300,000.
9. Since The Tech Museum of Innovation has not had a federal awards audit for several years, it did not qualify as a low-risk auditee.

Findings – Financial Statements Audit

None

THE TECH MUSEUM OF INNOVATION
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
YEAR ENDED DECEMBER 31, 2003

Findings and Questioned Costs

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 was 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 included requiring timecards of *all* employees, even if non-exempt. When the timecard is signed by the employees 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. Prioir 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.

THE TECH MUSEUM OF INNOVATION
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
YEAR ENDED DECEMBER 31, 2003

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.

THE TECH MUSEUM OF INNOVATION
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
YEAR ENDED DECEMBER 31, 2003

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) solicitations 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 preference, to the extent practicable and economically feasible, for products and services that conserve natural resources and protect the environment and are energy efficient
 - vi.

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
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
YEAR ENDED DECEMBER 31, 2003

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.

**THE TECH MUSEUM OF INNOVATION
STATUS OF PRIOR YEAR'S (2002) FINDINGS AND QUESTIONED COSTS
AS OF DECEMBER 31, 2003**

There were no prior year audit findings and questioned costs