

THE TECH MUSEUM
OF INNOVATION

Management Comment Letter
June 30, 2007

Board of Directors of
The Tech Museum of Innovation

In planning and performing our audit of the financial statements of The Tech Museum of Innovation (“The Tech” or the “Organization”) for the year ended June 30, 2007, in accordance with U.S. generally accepted auditing standards, we considered The Tech’s internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing an opinion on the financial statements but not for the purpose of expressing an opinion on the effectiveness of the organization’s internal control. Accordingly, we do not express an opinion on the effectiveness of the organization’s internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity’s ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity’s financial statements that is more than inconsequential will not be prevented or detected by the entity’s internal control. We did not identify any deficiencies in internal control that we consider to be significant deficiencies, as defined above.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity’s internal control. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above.

Our comments concerning internal control and other significant matters are presented as follows:

- **Current Year Matters**
- **Status of Prior Year Comments**
- **Changes Impacting Nonprofit Organizations**

This communication is intended solely for the information and use of management, and the Board of Directors and is not intended to be and should not be used by anyone other than these specified parties.

Board of Directors of
The Tech Museum of Innovation

We will be pleased to further discuss these matters with you and want to express our sincere appreciation for the cooperation and assistance received during the audit engagement and for the opportunity to serve The Tech.

Very truly yours,

A handwritten signature in black ink, appearing to read "Ingrid Santopietro". The signature is fluid and cursive, with a large initial "I" and a long, sweeping tail.

San Jose, California
October 26, 2007

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CURRENT YEAR MATTERS:

1. Documentation of approval and descriptions for adjusting journal entries

Observation:

As part of the audit, we reviewed the Tech's journal entries and requested hard copy supporting documentation for selected journal entries. During our review, it was noted that the hard copies did not indicate that the entries had been approved and some did not have supporting documentation. Additionally, the electronic version did not provide a detailed description for most of the entries.

Recommendation:

We recommend that management categorize journal entries into recurring journal entries and nonrecurring journal entries, where authorization for recurring journal entries is established at the beginning of the year. Nonrecurring journal entries would require individual authorization by management. Journal entries should always be supported by appropriate documentation where possible. Good documentation serves as an accounting record and facilitates future follow-up as well as additional insight for other users. We further recommend that the Chief Financial Officer review and approve all nonstandard journal entries and initial the support for the entries to document their approval. This process would improve controls over adjustments to the general ledger.

Management Response:

Plans are currently being finalized to engage an outside provider of comprehensive financial services, including compliance, accounting services, and financial reporting. As part of this new process, The Tech will adopt the recommendations described above: (a) journal entries will be categorized into either recurring or nonrecurring; (b) recurring journal entries will be annually authorized to the outside provider of accounting services; (c) nonrecurring journal entries will be reviewed, approved, and initialed by the Chief Financial Officer; and (d) all journal entries will be supported by appropriate documentation.

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2. Review “no sales” on cash register tapes

Observation:

Prior to the start of the audit, we were informed of instances in the guest services area where money was missing from the ticket sales. This was caught by management and properly treated. Inquiry was made to determine if management scans or reviews the cash register tapes for excessive “no sale” transactions – there was no such review.

Recommendation:

As part of monitoring The Tech’s revenues, cash register tapes should be reviewed on a periodic basis and monitored for unusual items, including excessive “no sale” transactions, as they are indicators of misuse of the registers.

Management Response:

With the implementation of the CRM system, new controls have been implemented, including the review and monitoring of system reports for unusual items, including excessive “no sale” transactions.

3. Review of investment statements

Observation:

During the audit, ISF inquired of management about reviewing The Tech’s adherence to its investment policy and whether the investment manager or custodians were being reviewed by anyone. Although review was being conducted by the finance committee, it was not documented in the minutes.

Recommendation:

As part of The Tech’s documentation of proper governance and the performance of the governing boards’ fiduciary duties, significant activities should be formally documented in the minutes of The Tech’s board or committees of the board.

Management Response:

As part of the Investment Committee’s responsibilities, the review of custodian investment data vis-à-vis investment manager investment data will be performed, with any large and/or unusual discrepancies resolved and will document such review.

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4. Timely bank reconciliations with sign-off

Observation:

During our testing over cash, it was noted that the bank reconciliation review for some of The Tech's accounts was not done in a timely manner. In addition, there was no indication of who performed the reconciliation or when.

Recommendation:

We recommend that all of the bank accounts be reconciled monthly to the general ledger and that all reconciling items be promptly investigated and adjusted with adequate explanations. The reconciliations should indicate the preparer and reviewer and the date of preparation and review.

Management Response:

All bank accounts will be reconciled monthly by the new outside provider of comprehensive financial services and reviewed / approved by The Tech in a timely manner.

5. Petty cash reconciliations

Observation:

ISF noted that there was no reconciliation or review being performed on one of the petty cash accounts.

Recommendation:

We recommend that all petty cash reconciliations be performed monthly to allow proper recognition of expenses and control over all petty cash accounts.

Management Response:

All petty cash accounts will be reconciled monthly.

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6. Audit committee minutes

Observation:

Our audit procedures disclosed that minutes of the meetings of the Audit Committee are not maintained. As a result, there is no assurance regarding the discussion that may have taken place at a meeting of the Audit Committee and likewise, no assurance regarding official actions of the Committee that may have had a financial impact.

Recommendation:

It is recommended that, in the future, minutes be promptly prepared and retained for all meetings of the Audit Committee.

Management Response:

At all future Audit Committee meetings, The Tech's Executive Administrative Assistant will be present to take notes, compile and issue meeting minutes in a prompt and timely fashion.

7. Whistleblower policy and new hire packet

Observation:

Per inquiry of an employee, it was noted that the individual did not receive documentation about a whistleblower policy in their new hire packet.

Recommendation:

It is recommended that complete new hire packets are distributed to new employees that include all applicable policies such as the whistleblower policy that the Organization adheres to.

Management Response:

A comprehensive employee file checklist is being created to help ensure that all new hires are provided with a complete set of policies and other documentation.

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STATUS OF PRIOR YEAR COMMENTS:

1. Asset Retirement Obligations

Observation:

FASB issued Financial Interpretation No. 47 (“FIN 47”) an interpretation of FASB Statement No. 143, *Accounting for Asset Retirement Obligations*, which clarifies the term *conditional asset retirement obligation* as used in FASB Statement No. 143, *Accounting for Asset Retirement Obligations*, and refers to a legal obligation to perform an unconditional asset retirement activity. It is unconditional even though uncertainty exists about the timing and (or) method of settlement since this may or may not be within the control of the entity. Accordingly, an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated and should be recognized when incurred—generally upon acquisition, construction, or development and (or) through the normal operation of the asset. The Foundation had not addressed the implication of FIN 47 on its leased buildings holdings.

Recommendation:

The Tech should be familiar with FIN 47 and evaluate all leases to determine whether there is a liability associated with future remediation that should be recorded.

Management Response:

The Tech has entered into a long-term lease with the City of San Jose, CA for “... a permanent facility comprised of a technology museum and large screen theater, “that runs through the year 2053 (Note 4).

Upon surrender of the facility, The Tech has, at its election, the right to either remove all personal property, Exhibits and Exhibit and program Furniture Fixtures & Equipment belonging to The Tech, or abandon such items to “... become City’s property, free and clear of all claims to or against it by TMI, and may be disposed of by City by private sale or other means ...”. The building itself is subject to “ordinary wear and tear” provisions.

Based upon the above stated lease provisions, The Tech does not believe that a liability associated with future remediation is necessary under FIN 47 and FASB Statement No. 143.

Current Status:

Management has evaluated all leases for FIN 47.

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2. Evaluate changing management roles to ensure oversight is present

Observation:

During one of ISF's meetings with the VP Admin/CFO, the CFO's role was discussed during which it was noted that while the CFO was given more authority, there was less oversight. Although, the Organization has a dual check signing policy, per discussions with the CFO, the secondary check signor will sign the checks but does not review the supporting documentation.

Recommendation:

As roles change within the Organization due to employee turnover or restructuring, the Organization must evaluate the changing roles to ensure no one individual has increasing control without a comparable increase in oversight by the board or by another responsible person. It is recommended the Organization assign another person to review the financials monthly and to approve them. Additionally, the Organization should consider hiring another individual in finance in an effort to ease some of the work load the CFO has taken on over the prior year.

Management Response:

In January 2007, an additional individual was hired in the role of Senior Director of Finance and Administration, thereby providing increased oversight, while at the same time easing some of the work load of the CFO.

Current Status:

In addition to the Management Response, as stated above, plans are currently being finalized to engage an outside provider of comprehensive financial services, including compliance, accounting services, and financial reporting. This arrangement will provide additional oversight, ease some work load issues, and provide continuity in face of personnel turnover and / or restructurings.

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3. Approval of moving expenses

Observation:

During ISF's testing related to disbursements and accruals, it was noted there were expenses incurred to move the Organization's new President from Germany. ISF inquired about the relocation agreement referred to in the new President's employment agreement, it was noted that one had not been executed and there was no board approval of these expenses.

Recommendation:

When the Organization has made a commitment to pay for certain expenses that are not in the normal course of business or exceed a certain dollar amount, the agreement should be documented in writing. At a minimum, there should be a policy stating how much can be expended without board approval and expenses above this amount should be specifically approved by the board and documented in the minutes as having been approved. Additionally, SB 1262, *The Nonprofit Integrity Act of 2004*, provides that the board of directors (or an authorized committee) shall review and approve the compensation, including benefits, of the chief executive officer and the chief financial officer of the charitable organization. All organizations subject to the Act must conduct this review, regardless of revenue level, and the review must occur when the officer is hired, when the term of employment of the officer is renewed or extended, and when the compensation is modified, unless the modification applies to substantially all employees.

Management Response:

Although not specifically approved by the full Board and documented in the minutes as having been approved, the nature of the reimbursed moving expenses were reviewed and approved by several Board members of the Search Committee, which was authorized by the full Board to enter into an employment agreement, including relocation expenses, with the President.

Current Status:

There are no further expenses as such in 2007.

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4. Cross training of employees

Observation:

During ISF's testing over payroll expenses, the 941's for the period under audit were requested. The Organization could not provide these to us timely since the Benefits/Payroll Manager was on vacation and this individual was the only one who had access to them – even the HR Director, could not access the 941's.

Recommendation:

All employee positions should have some cross training so that when employees go on vacation there is no disruption to the Organization's normal course of business. Additionally, no one person should be the only one that has access to the Organization's information whether it is electronic access or possession of hard copy documents. This can be accomplished by cross training and proper planning prior to an employee's vacation.

Management Response:

With the addition of the new Senior Director of Finance and Administration discussed in "*Evaluate changing management roles to ensure oversight is present*" above, cross training and the redistribution of some key responsibilities have occurred, thereby minimizing any potential disruption to the Organization's normal course of business upon periods of vacation within the business operations.

Current Status:

As indicated in the current response to "*Evaluate changing management roles to ensure oversight is present*" above, "...plans are currently being finalized to engage an outside provider of comprehensive financial services, including compliance, accounting services, and financial reporting. This arrangement will provide additional oversight, ease some work load issues, and provide continuity in face of personnel turnover and / or restructurings." This also applies to periods of vacation by staff members.

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5. Custody of Organization documents

Observation:

ISF requested to see the Organization's employee stock option statements from Charles Schwab. All but one was available as this was being mailed to the employee's home rather than to the Organization.

Recommendation:

All of the Organization's bank statements should be mailed to the Organization directly with a copy being sent to the employee for their records.

Management Response:

All employees currently associated with the Organization's employee stock option plan have their statements mailed directly to the Organization.

Current Status:

All stock option statements are now being mailed to the Organization

6. Testing of Organization's disaster recovery plan

Observation:

Although the organization does have a disaster recovery plan indicating personnel, their contact numbers, a listing of data files, offsite storage, and computer vendors that would be involved in case of an emergency, the plan has not been tested.

Recommendation:

The Organization should test its disaster recovery plan on a regular basis. The most important step to implement is testing of the backup data. Currently, the Organization is making backups and storing these offsite but is not testing them. If data cannot be retrieved from these backups when needed, the Organization will lose significant data which may not be able to be restored or it will require valuable resources to compile.

Management Response:

The Organization is in the process of converting to a new, enterprise wide data management system that will be hosted offsite, including all backup related activities. This outsourcing of management information systems hosting to a professional outside entity will all but eliminate the risk of non- functioning backup data capabilities.

Current Status:

The conversion is complete, however the plan still has not been tested besides the preliminary set-up.

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CHANGES IMPACTING NONPROFIT ORGANIZATIONS

The bar is being raised for nonprofit organizations due to changing public expectations resulting in new audit standards that increase focus on effective internal control systems and processes. These changes have been triggered by fraud, scandals, and financial reporting problems in both for-profit and nonprofit organizations.

Regulators and the public have realized that *the reliability of financial reporting is directly related to the sufficiency and effectiveness of an organization's internal control systems and processes*, and the quality of a financial statement audit must be based on this evaluation. The public is seeking assurance that an organization has proper financial safeguards and protections.

As a result, the Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants (AICPA) has issued new standards that have a significant impact on audits and organizations audited by requiring greater attention to internal control systems and processes. They emphasize the distinctions between auditors' responsibility and responsibility of an organization's governing board and management.

The new standards require that internal control deficiencies identified during an audit be evaluated and reported using a different measure than has been in place, which may result in increased reporting of internal control deficiencies.

The bottom line—there must be reasonable attention to monitoring and oversight of an organization's internal controls that is commensurate with the attention commonly given to financial reporting.

Admittedly, this will sound more daunting and onerous than it is in fact. It is a focus, a way of thinking, and a process of managing an internal control framework. The increased requirements and costs may not be as dramatic as they may first appear. For example, an audit committee may need to spend additional time considering internal controls, the finance team may need to spend more time in process management, and there may need to be increased internal audit activities. However, these activities should result in increased efficiencies and long term cost savings.

The new auditing standards:

- SAS 104 through 111, *Risk Assessment Standards*, are effective for fiscal periods **beginning on or after** December 15, 2006. These standards increase the auditors' responsibility and requirements, including more extensive understanding of the organization and documentation of audit procedures.

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CHANGES IMPACTING NONPROFIT ORGANIZATIONS, continued:

The new auditing standards, continued:

- SAS 112, *Communication of Internal Control Matters*, is effective for fiscal periods **ending on or after** December 15, 2006, and changes the definition of internal control deficiencies:
 - A **control deficiency** exists when the design or operation of an internal control would not prevent or detect financial misstatements.
 - A **significant deficiency** occurs when a control deficiency allows more than a remote likelihood of a misstatement that is more than inconsequential.
 - A **material weakness** is a significant deficiency that allows more than a remote likelihood of a material misstatement.
- SAS 114, *The Auditor's Communication With Those Charged With Governance*, is effective for fiscal periods **beginning on or after** December 15, 2006. This standard increases the auditors' responsibility to communicate information about audit planning, the client's accounting practices, and other significant matters.

The impact of the new auditing standards on audits:

- Auditors must test and document more, and be less predictable (clients may have less time to prepare for certain testing and response).
- Auditors must perform the audit with increased skepticism, requiring auditors to obtain and scrutinize more supporting evidence. Audits will take longer and be more rigorous.
- Clients will be asked to provide documentation of their risk assessment and internal controls, as well as an evaluation of their effectiveness.
- The auditors' letter of recommendations (management comment letter) must address internal control deficiencies at an increased level.
- Unfavorable management letters may affect public perceptions about an organization's stewardship and affect the ability to continue to receive funding. Savvy users of financial statements; such as banks, foundations, charity watchdog groups, and regulators, may ask about internal control deficiencies.

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CHANGES IMPACTING NONPROFIT ORGANIZATIONS, continued:

The impact of the new auditing standards on nonprofit organizations:

- Nonprofit organizations seeking to manage risk and avoid negative comments must understand the COSO framework for internal control and its five key components. (See COSO integrated framework below, from the 1992 report of The Committee of Sponsoring Organizations of the Treadway Commission, designed to help businesses and other entities assess and enhance their internal control systems.) Traditionally, organizations have focused primarily on a single element of the framework—control activities.
- Sufficient attention and resources must be allocated to establish, document, and maintain an effective system of internal controls, including an assessment of key risks that could have a significant affect on financial activities and reporting.
- Audit committees need to be empowered to monitor and oversee management’s risk assessment, internal control documentation, and evaluation of effectiveness.
- Boards and management need to affirm to auditors, and if appropriate or required to constituencies and regulators, their responsibility for and maintenance of rigorous systems and processes to protect the organization, its assets, its people, and its reputation.

This is an ongoing process and not a one time event. The financial statement audit is an annual “inspection” rather than a component of “monitoring” maintained by management under the oversight of the governing body.

We recommend studying the COSO internal control guidance and related tools as a means to begin the process of implementation. The principle based evaluation matrix included in the materials is a key starting point to highlight areas of vulnerability.

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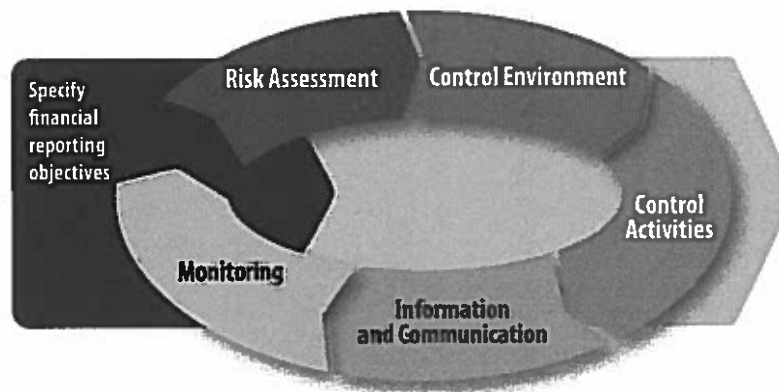
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CHANGES IMPACTING NONPROFIT ORGANIZATIONS, continued:

The COSO integrated framework:

The five key components of an effective system of internal controls over financial reporting:

- **Control environment** (establishing organizational values and control structure, policies, management philosophy, and staff capabilities)
- **Risk assessment** (assessing key risks, including those resulting from fraud and errors)
- **Control activities** (implementing policies and procedures, and safeguards that mitigate risks)
- **Information and communication** (providing financial and other information to those inside and outside of the organization to enable the system to properly function)
- **Monitoring** (evaluating whether controls operate effectively)



There are many practical tools and materials to assist in this process that are “scalable” to fit the size and complexity of different organizations in a cost effective manner. See also www.coso.org.

The ultimate benefit and payoff:

Those who have gone through such a process recognize that there are many benefits including:

- Increased ability to anticipate and/or avoid problems and mitigate risks
- Enhanced decision making that avoids unanticipated outcomes
- Realization of increased operational efficiency and effectiveness
- Long-term financial and resource savings