

Financial Statements

HOUSE EAR INSTITUTE

June 30, 2003



HENSIEK & CARON

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INDEPENDENT AUDITOR'S REPORT

To The Board of Directors
House Ear Institute

We have audited the accompanying statement of financial position of House Ear Institute (a nonprofit corporation) as of June 30, 2003, and the related statements of activities, changes in net assets, cash flows, and functional expenses 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 House Ear Institute as of June 30, 2002, were audited by other auditors whose report dated October 7, 2002, expressed an unqualified opinion.

We conducted our audit in accordance with U.S. generally accepted auditing standards, 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 audit to obtain reasonable assurance about whether the financial statement is 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 referred to above present fairly, in all material respects, the financial position of House Ear Institute as of June 30, 2003, and the changes in its net assets and its cash flows for the year then ended, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued a report dated September 23, 2003, on our consideration of House Ear Institute's internal control structure over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants.

A handwritten signature in cursive script that reads "Hensiek & Caron" followed by a horizontal line.

September 23, 2003

HOUSE EAR INSTITUTE
STATEMENTS OF FINANCIAL POSITION
JUNE 30, 2003

ASSETS

	2003	2002
Cash, including restricted amounts of \$1,042,748	\$ 2,903,476	\$ 2,050,440
Bequests and other donations receivable	3,268,200	-
Accounts receivable, net of allowance for uncollectible accounts of \$488,691 in 2003 and \$318,578 in 2002	1,326,329	1,464,688
Educational and research supplies	100,476	115,566
Prepaid expenses and other assets	58,168	75,307
Pledges receivable, net of allowance for uncollectible pledges of \$6,550 in 2003 and \$6,550 in 2002	1,769,160	2,000,749
Notes receivable	192,275	205,824
Investments	31,342,327	29,849,253
Assets of split-interest agreements	2,492,594	2,657,220
Patent development costs	118,397	83,031
Patent costs, net of accumulated amortization of \$38,657 in 2003 and \$30,910 in 2002	92,685	100,432
Deferred bond costs, net of accumulated amortization of \$426,508 in 2003 and \$410,304 in 2002	251,147	267,350
Cash surrender value of life insurance	60,456	50,178
Facilities and equipment, at cost, net	26,537,138	27,967,930
Total Assets	\$ 70,512,828	\$ 66,887,968

LIABILITIES AND NET ASSETS

Accounts payable and accrued expenses	\$ 1,261,270	\$ 1,370,689
Accrued bond interest payable	16,584	29,892
Note payable	1,621,813	1,780,319
Deferred revenue	1,204,305	1,622,519
Liability to beneficiaries under split-interest agreements	1,178,915	1,786,873
Deferred revenue - pooled income fund	55,998	60,475
Bonds payable	14,180,000	14,635,000
Deferred compensation plan	254,928	156,071
Total Liabilities	19,773,813	21,441,838
Unrestricted Net Assets		
Undesignated fund	20,430,588	17,199,423
Designated by Board of Trustees:		
Adrian Wood Memorial	1,500,000	1,500,000
Bond Retirement	9,571,023	8,292,454
Total Unrestricted Net Assets	31,501,611	26,991,877
Temporarily Restricted Net Assets	7,484,222	8,009,556
Permanently Restricted Net Assets	11,753,182	10,444,697
Total Net Assets	50,739,015	45,446,130
Total Liabilities and Net Assets	\$ 70,512,828	\$ 66,887,968

HOUSE EAR INSTITUTE
STATEMENTS OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2003
WITH SUMMARIZED INFORMATION FOR THE YEAR ENDED JUNE 30, 2002

	2003			2002	
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
Public Support and Revenue					
Contributions	\$ 10,698,380	\$ 1,663,398	\$ 1,308,485	\$ 13,670,263	\$ 8,755,282
Grants and contracts	7,517,537	-	-	7,517,537	8,510,912
Educational courses	97,974	-	-	97,974	145,827
Investment returns, net	1,884,566	264,445	-	2,149,011	21,818
Building operations	657,678	-	-	657,678	783,568
Clinical services	846,403	-	-	846,403	720,896
Royalties	1,297,124	-	-	1,297,124	505,150
Other	47,874	-	-	47,874	158,178
Change in value of split-interest agreements	-	381,289	-	381,289	(383,386)
Net assets released from restrictions	2,834,466	(2,834,466)	-	-	-
Total Public Support and Revenue	25,882,002	(525,334)	1,308,485	26,665,153	19,218,245
Expenses					
Program Services					
Research	12,623,662	-	-	12,623,662	11,561,441
Education	605,596	-	-	605,596	516,214
Total Program Services	13,229,258	-	-	13,229,258	12,077,655
Supporting Services					
Management and general	6,543,773	-	-	6,543,773	8,134,674
Fund raising	1,217,993	-	-	1,217,993	1,143,137
Total Supporting Services	7,761,766	-	-	7,761,766	9,277,811
Total Expenses Before Debt Service Costs	20,991,024	-	-	20,991,024	21,355,466
Change in Net Assets Before Debt Service Costs	4,890,978	(525,334)	1,308,485	5,674,129	(2,137,221)
Debt Service Costs	381,244	-	-	381,244	556,183
Change in Net Assets	\$ 4,509,734	\$ (525,334)	\$ 1,308,485	\$ 5,292,885	\$ (2,693,404)

HOUSE EAR INSTITUTE
STATEMENTS OF CHANGES IN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2003

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Net Assets, June 30, 2001	\$ 11,143,858	\$ 27,072,897	\$ 9,922,779	\$ 48,139,534
Change in Net Assets	<u>15,848,019</u>	<u>(19,063,341)</u>	<u>521,918</u>	<u>(2,693,404)</u>
Net Assets, June 30, 2002	26,991,877	8,009,556	10,444,697	45,446,130
Change in Net Assets	<u>4,509,734</u>	<u>(525,334)</u>	<u>1,308,485</u>	<u>5,292,885</u>
Net Assets, June 30, 2003	<u>\$ 31,501,611</u>	<u>\$ 7,484,222</u>	<u>\$ 11,753,182</u>	<u>\$ 50,739,015</u>

**HOUSE EAR INSTITUTE
STATEMENTS OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2003**

	<u>2003</u>	<u>2002</u>
Cash Flows from Operating Activities		
Cash received from service recipients	\$ 9,539,845	\$ 9,585,688
Cash received from donors	9,606,261	7,045,667
Cash received from building operations, net	657,678	783,568
Cash paid to suppliers and employees	(18,726,369)	(18,374,693)
Interest and dividends received	1,138,595	1,257,522
Interest paid	<u>(394,552)</u>	<u>(551,696)</u>
Net Cash Provided by (Used in) Operating Activities	<u>1,821,458</u>	<u>(253,944)</u>
Cash Flows from Investing Activities		
Additions to facilities and equipment	(966,459)	(1,341,563)
Purchases of investments	(1,938,401)	(3,014,172)
Proceeds from sale of investments	2,014,480	6,672,330
Loans made	(50,000)	-
Collections on loans	<u>63,546</u>	<u>146,610</u>
Net Cash Provided by (Used in) Investing Activities	<u>(876,834)</u>	<u>2,463,205</u>
Cash Flows from Financing Activities		
Proceeds from donations and investment earnings restricted for:		
Endowment	521,918	66,500
Redemption of bonds	(455,000)	(430,000)
Proceeds from line of credit, net	<u>(158,506)</u>	<u>(120,240)</u>
Net Cash Used in Financing Activities	<u>(91,588)</u>	<u>(483,740)</u>
Net Increase in Cash	853,036	1,725,521
Cash, Beginning	<u>2,050,440</u>	<u>324,919</u>
Cash, Ending	<u><u>\$ 2,903,476</u></u>	<u><u>\$ 2,050,440</u></u>

**HOUSE EAR INSTITUTE
STATEMENTS OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2003
(Continued)**

	<u>2003</u>	<u>2002</u>
Reconciliation of the Change in Net Assets		
To Net Cash Provided by (Used in) Operating Activities		
Change in Net Assets	\$ 5,292,885	\$ (2,693,404)
Adjustments to reconcile the change in net assets to net cash provided by (used in) operating activities		
Bad debts	170,113	112,557
Change in present value of pledges receivable	(20,411)	(55,412)
Change in allowance for uncollectible pledges	-	1,550
Depreciation and amortization	2,225,356	2,127,834
Loss on disposal of fixed assets	195,845	-
Realized and unrealized gains on investments	(1,095,522)	840,844
Partnership (income) loss	(32,373)	(4,932)
Cash surrender value of life insurance	(10,278)	(10,525)
Donations of noncash assets	(441,258)	(482,826)
(Increase) Decrease in:		
Donations receivable	(3,268,200)	-
Accounts receivable	(31,751)	(328,177)
Educational and research supplies	15,090	12,762
Pledges receivable	252,000	(758,000)
Assets of split-interest agreements	164,626	258,395
Prepaid expenses and other assets	17,139	100,146
Patent development costs	(35,366)	(62,851)
Increase (Decrease) in:		
Accounts payable and accrued expenses	(109,419)	955,104
Accrued bond interest payable	(13,308)	(5,858)
Other deferred revenue	(418,214)	(258,544)
Liability to beneficiaries under split-interest agreements	(612,435)	87,991
Deferred compensation plan	98,857	(24,098)
Donations restricted for long-term purposes:		
Cash donations	<u>(521,918)</u>	<u>(66,500)</u>
 Net Cash Provided by (Used in) Operating Activities	 <u><u>\$ 1,821,458</u></u>	 <u><u>\$ (253,944)</u></u>

HOUSE EAR INSTITUTE
STATEMENTS OF FUNCTIONAL EXPENSES
FOR THE YEARS ENDED JUNE 30, 2003
WITH SUMMARIZED INFORMATION FOR JUNE 30, 2002

	2003						2002
	Program Services			Supporting Services			Total Expenses
	Research	Education	Total	Management and General	Fund Raising	Total	
Salaries and wages	\$ 6,659,198	\$ 218,643	\$ 6,877,841	\$ 2,668,800	\$ 518,773	\$ 3,187,573	\$ 10,065,414
Taxes and employee benefits	1,437,124	47,023	1,484,147	473,008	111,644	584,652	2,068,799
Total Personnel Costs	8,096,322	265,666	8,361,988	3,141,808	630,417	3,772,225	12,134,213
Professional fees and contract service payments	941,246	48,660	989,906	795,736	215,728	1,011,464	2,001,370
Occupancy and related expenses	160,710	1,983	162,693	1,263,166	1,845	1,265,011	1,427,704
Travel, conferences, conventions and meetings	184,700	94,513	279,213	110,521	23,321	133,842	413,055
Special supplies and services	807,555	25,093	832,648	130,749	87,714	218,463	1,051,111
Cost of goods sold	276,092	-	276,092	-	-	-	276,092
Minor equipment and equipment maintenance	198,002	1,728	199,730	88,053	1,660	89,713	289,443
Office supplies and services	315,102	122,547	437,649	577,808	181,173	758,981	1,196,630
Total Expenses Before Depreciation	10,979,729	560,190	11,539,919	6,107,841	1,141,858	7,249,699	18,789,618
Depreciation - building	964,420	36,132	1,000,552	320,432	37,354	357,786	1,358,338
Depreciation - equipment and furniture	679,513	9,274	688,787	115,500	38,781	154,281	843,068
Total Expenses Before Debt Service Costs	<u>\$ 12,623,662</u>	<u>\$ 605,596</u>	<u>\$ 13,229,258</u>	<u>\$ 6,543,773</u>	<u>\$ 1,217,993</u>	<u>\$ 7,761,766</u>	<u>\$ 20,991,024</u>
						<u>\$ 20,991,024</u>	<u>\$ 21,355,466</u>

HOUSE EAR INSTITUTE
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2003

Note 1 - Summary of Significant Accounting Policies

Organization

House Ear Institute (the Institute) is a nonprofit California corporation that was formed in 1946 for the principal purpose of developing conceptually and technically feasible approaches to resolving disorders of hearing and balance through basic and applied research; for testing the practicality of solutions through selective clinical applications; and for communicating the results to hearing health care professionals and the public through educational programs, reports, films and other means.

The Institute was established by Dr. Howard House in 1946 and is dedicated to improving the quality of life for people who have hearing and related disorders through research and education. Since its inception, scientists at the Institute have been engaged in an exploration of the auditory system from the ear canal through the inner ear and into the cortex of the brain and have sought to improve hearing aids and auditory implants and develop innovative treatments and intervention methods.

The Institute's mission continues to be centered around the exploration of the structure of the auditory cellular and molecular mechanisms with a goal of obtaining a better understanding of how a normal ear develops, matures and functions in order to provide greater potential for discovering cures for sensorineural hearing loss and some of the many unsolved causes of deafness and ear disease.

Public Support and Revenue

Donations, including unconditional promises to give (pledges), are recorded as made. All donations are considered to be available for unrestricted use unless specifically restricted by the donor.

Conditional promises to give are recorded when the conditions on which they depend are substantially met. Unconditional promises to give are recorded as verifiable documentation of a promise is received. Promises to give that are due in the next year are recorded as current at their net realizable value; those due in subsequent years are reflected as long-term promises to give and are recorded at the present value of their net realizable value, discounted using low-risk interest rates applicable to the year in which the promise was received. An allowance for uncollectible promises is provided based on management's evaluation of potential uncollectible promises receivable at year end.

Amounts received or promised that are designated for future periods or restricted by the donor for specific purposes are reported as temporarily or permanently restricted support that increases those net asset classes. When a temporary restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restriction.

Donated securities and other non-cash donations are recorded as donations at their estimated fair values at the date of donation.

HOUSE EAR INSTITUTE
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2003

Note 1 - Summary of Significant Accounting Policies (continued)

Public Support and Revenue (continued)

A substantial number of volunteers donate significant amounts of their time to the Institute's programs and other services. However, since no objective basis exists for measuring and valuing these services, they are not reflected in the accompanying financial statements.

Medical and Research Supplies

Inventories of medical and research supplies are stated at the lower of cost or market determined by the first-in first-out method.

Investments

Investments are valued at fair value, with realized and unrealized gains and losses reflected in the statements of activities. The fair value of investments is generally based on quoted market value.

The Institute uses an investment pooling method for accounting for investments. Investment income is allocated to the various classes of net assets on an estimated average annual rate of return on the investment pools.

Facilities and Equipment

Facilities and equipment are recorded at cost at the date of acquisition or at fair market value at the date of donation. Depreciation is provided, using the straight-line method, over the following estimated useful lives:

Medical and research facility	30 years
Equipment and furniture	5 to 10 years

The costs of tenant improvements are depreciated over the term of each lease, including renewal options.

Deferred Revenue

Tuition fees received in advance are reported as deferred revenue until the related seminar is held. Deposits on leases of the building are also classified as deferred revenue.

Comparative Financial Information

The financial statements include certain prior-year summarized comparative information in total but not by net asset class. Such information should be read in conjunction with the Institute's financial statements for the year ended June 30, 2002. Certain reclassifications have been made to June 30, 2002, to be comparative to June 30, 2003.

**HOUSE EAR INSTITUTE
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2003**

Note 1 - Summary of Significant Accounting Policies (continued)

Statement of Cash Flows

For the purpose of the statement of cash flows, the Institute includes all cash in banks and other financial institutions.

Income Taxes

The Institute is qualified under Section 501(c)(3) of the Internal Revenue Code and is not classified as a private foundation. Nonprofit organizations are not generally liable for taxes on income; therefore, no provision is made for such taxes in the financial statements.

Expense Allocation

The costs of providing various programs and other activities have been summarized on a functional basis in the statement of activities and in the statement of functional expenses. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent 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 those estimates.

Note 2 - Concentration of Credit Risk

The Institute maintains its cash balances at various financial institutions. Cash accounts are insured by the Federal Deposit Insurance Corporation up to \$100,000 per institution. At June 30, 2003, the Institute's uninsured cash balance totaled \$2,509,673.

Note 3 - Pledges Receivable

Unconditional promises to give consist of the following:

	<u>2003</u>	<u>2002</u>
Receivable in less than one year	\$ 978,406	\$ 1,204,406
Receivable in one to five years	836,152	857,152
Receivable in more than five years	-	5,000
	<hr/>	<hr/>
Total unconditional promises to give	1,814,558	2,066,558
Less discounts to net present value	(38,848)	(59,259)
Less allowance for uncollectible promises	(6,550)	(6,550)
	<hr/>	<hr/>
Net unconditional promises to give	<u>\$ 1,769,160</u>	<u>\$ 2,000,749</u>

HOUSE EAR INSTITUTE
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2003

Note 3 - Pledges Receivable (continued)

	<u>2003</u>	<u>2002</u>
Restricted for:		
Building maintenance and debt reduction	\$ 358,217	\$ 492,528
Specific research projects	434,105	1,010,907
Endowment	96,803	10,000
Unrestricted	<u>880,035</u>	<u>487,314</u>
Total	<u>\$ 1,769,160</u>	<u>2,000,749</u>

Note 4 - Investments

As of June 30, 2003 and 2002, investments consist of the following:

<u>2003</u>	<u>Aggregate Fair Value</u>	<u>Cost</u>
Cash & cash equivalents	\$ 1,637,554	\$ 1,637,554
Corporate stocks	5,802,712	4,512,565
Mutual funds	13,747,384	12,790,677
United States Treasury notes	9,571,023	6,187,853
Other	<u>583,654</u>	<u>643,129</u>
	<u>\$31,342,327</u>	<u>\$25,771,778</u>
<u>2002</u>	<u>Aggregate Fair Value</u>	<u>Cost</u>
Cash & cash equivalents	\$ 1,785,047	\$ 1,785,047
Corporate stocks	6,290,442	5,177,319
Mutual funds	12,755,669	12,283,590
United States Treasury notes	8,292,454	5,799,446
Other	<u>725,641</u>	<u>598,519</u>
	<u>\$29,849,253</u>	<u>\$25,643,921</u>

Investment returns are summarized as follows:

<u>2003</u>	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
Interest and dividends	\$ 1,033,213	\$ 144,982	\$ 1,178,195
Net realized and unrealized gains	954,376	133,919	1,088,295
Investment fees	<u>(103,023)</u>	<u>(14,456)</u>	<u>(117,479)</u>
Total	<u>\$ 1,884,566</u>	<u>\$ 264,445</u>	<u>\$ 2,149,011</u>

**HOUSE EAR INSTITUTE
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2003**

Note 4 - Investments (continued)

<u>2002</u>	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
Interest and dividends	\$ 952,222	\$ -	\$ 952,222
Net realized and unrealized gains	(835,912)	-	(835,912)
Investment fees	(94,492)	-	(94,492)
Total	<u>\$ 21,818</u>	<u>\$ -</u>	<u>\$ 21,818</u>

Note 5 - Split-interest Agreements

The Institute administers two types of split-interest agreements:

Charitable remainder trusts provide for the payment of distributions to the grantor or other designated beneficiaries over the trust's term (usually the designated beneficiary's lifetime). At the end of the trust's term, the remaining assets are available for the Institute's use. The portion of the trust attributable to the present value of the future benefits to be received by the Institute is recorded in the statement of activities as a temporarily restricted contribution in the period the trust is established. Assets held in the charitable remainder trusts are reported at fair market value in the Institute's statement of financial position. On an annual basis, the Institute revalues the liability for future distributions to the designated beneficiaries based on actuarial assumptions. The present value of the estimated future payments is calculated using a discount rate of 10% and applicable mortality tables.

Pooled income funds are arrangements whereby many donors' life income gifts are invested and pooled together, and each donor is assigned a relative number of units in the pool. Contribution revenue has been recorded at the fair value of the assets received, discounted at 10% for the estimated time period until each donor's death. The difference between the fair value of the assets received and the revenue recognized as a contribution is recorded as deferred revenue – pooled income fund, representing the amount of discount for future interest. Until a donor's death, the donor is paid the actual income earned on the donor's units in the pooled income fund. Upon a donor's death, the value of the donor's units reverts to the Institute.

Note 6 - Facilities and Equipment

Facilities and Equipment consists of the following:

	<u>2003</u>	<u>2002</u>
Building	\$38,152,543	\$37,707,651
Furniture and equipment	9,115,016	8,897,511
Construction in progress	284,911	392,704
	<u>47,552,470</u>	<u>46,997,866</u>
Less accumulated depreciation	21,015,332	19,029,936
	<u>\$26,537,138</u>	<u>\$27,967,930</u>

HOUSE EAR INSTITUTE
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2003

Note 7 - Bonds Payable

On May 20, 1993, the Institute issued \$17,685,000 in 1993 Series A Tri-modal Variable Rate Revenue Refunding Certificates of Participation (the Bonds). Proceeds from the Bonds were used to fund the redemption of the Institute's 1988 Series A Insured Health Facility Revenue Bonds, accrued interest thereon, and costs associated with their redemption and the issuance of the new Bonds. The Institute has a letter of credit to guarantee payment of the Bonds in the event of default. The letter of credit is unsecured.

Costs related to the redemption of the old bonds and to the underwriting and issuance of the new bonds have been capitalized and are amortized over the remaining term of the Bonds.

The Bonds carry a variable interest rate, as determined by the remarketing agent on a daily basis until converted to either a weekly variable rate or a fixed rate, at the option of the Institute (subject to certain restrictions). Interest is payable quarterly on March 1, June 1, September 1, and December 1. In addition to the mandatory redemption requirements shown below, the Institute has an early redemption option during any period where the daily or weekly variable rate applies at a price equal to 100% of the Bonds' face value, or during a period where a fixed rate applies at a price not in excess of 102%. The Bonds mature no later than December 1, 2018.

The Bond documents contain several covenants, the most significant of which are minimum requirements for ratios of fund balances to fixed assets as well as liquid assets as a percentage of long-term debt.

The Bonds are subject to mandatory redemption prior to their stated maturity, on December 1 each year, as follows:

2004	\$ 485,000
2005	520,000
2006	555,000
2007	590,000
2008	625,000
Thereafter, through 2018	<u>11,405,000</u>
	<u><u>\$14,180,000</u></u>

Interest expense incurred in connection with these bonds for the years ended June 30, 2003 and 2002, was \$174,359 and \$231,580, respectively. The effective variable interest rate at June 30, 2003 and 2002, was 1.00% and 1.85%, respectively.

**HOUSE EAR INSTITUTE
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2003**

Note 8 - Note Payable

The Institute has a promissory note, which is payable in monthly installments of \$21,191 including interest at the banks reference rate plus .25%, due on demand.

If no demand is made, it is due March 15, 2006. Assuming no demand is made, minimum payments are as follows:

2004	\$ 176,618
2005	185,783
2006	1,250,012
	\$ 1,612,413

Note 9 - Employee Annuity Plan

The Institute has an employee annuity plan which covers employees with one year of service and who work at least 30 hours per week. The Institute contributes 3% of each employee's eligible salary, and makes matching contributions up to fifty cents for every one dollar an eligible employee contributes. The Institute's total contribution will not exceed 5% for each employee. Employer contributions for the years ended June 30, 2003 and 2002 were \$396,843 and \$394,524, respectively.

Note 10 - Deferred Compensation Plan

The Institute established a deferred compensation plan covering management or other highly compensated employees as defined by ERISA and chosen by the compensation committee of the Board of Directors. The Board of Directors determines the amount of the employer's contribution annually. The employer contributions for the year ended June 30, 2003 and 2002 were \$46,687 and \$31,026, respectively.

Note 11 - Building Operations

The Institute's medical and research facility is comprised of a total of 108,109 square feet. The Institute occupies approximately 69% of the building. The portion of the facility not occupied by the Institute is leased to various medical practitioners, including the House Ear Clinic. All leased space is rented at prevailing market rates. The majority of the lease arrangements are for five-year years with options to renew at the discretion of the Institute, thereby allowing flexibility for growth for the Institute. Future minimum lease payments are as follows:

<u>Years ending June 30,</u>	
2004	\$ 523,055
2005	523,055
2006	493,704
2007	472,914
2008	465,984

HOUSE EAR INSTITUTE
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2003

Note 12 - Related-Party Transactions

The Institute leases the land on which the medical and research facility is located from St. Vincent Medical Center for \$1 for a 99-year term ending December 31, 2085. Management cannot readily determine the annual fair value of this ground lease for the years ended June 30, 2003 and 2002; therefore, it is not reflected in the accompanying financial statements.

The House Ear Clinic (the Clinic), an organization of ear specialists in private practice, provides to the Institute (at no cost) patient histories and patient volunteers with specific auditory problems. Drs. Howard House, John House, Derald Brackmann and Antonio De La Cruz, who are stockholders of the Clinic, are also members of the Institute's Board of Trustees and, with other members of the Clinic, provide the Institute with research, education and fundraising assistance.

During the years ended June 30, 2003 and 2002, the Institute received rental income from the Clinic of \$427,152 and \$483,344, respectively. In addition, at June 30, 2003, the Clinic owed the Institute \$2,410 for current tenant costs. Nothing was owing at June 30, 2002.

A member of the Institute's Board of Trustees currently serves as a principal with an organization providing investment advisory services to the Institute. During the years ended June 30, 2003 and 2002, fees paid to the organization for services provided were \$79,784 and \$96,632, respectively.

ADDITIONAL INFORMATION



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INDEPENDENT AUDITOR'S REPORT ON ADDITIONAL INFORMATION

To the Board of Directors
House Ear Institute

Our audits of the preceding basic financial statements were made to form an opinion on the basic financial statements taken as a whole. The accompanying Schedules of Changes in Net Assets and Expenditures of Federal Awards are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits 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.

Hensiek & Caron

September 23, 2003

HOUSE EAR INSTITUTE
SCHEDULE OF CHANGES IN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2003

	2002	Donations Income and Transfers	Expenditures and Transfers	2003
Unrestricted Net Assets - Board Designated				
Adrienne Wood Memorial	\$ 1,500,000	\$ -	\$ -	\$ 1,500,000
Bond retirement	8,292,454	1,278,569	-	9,571,023
Total Unrestricted Net Assets - Board Designated	\$ 9,792,454	\$ 1,278,569	\$ -	\$ 11,071,023
Permanently Restricted Net Assets				
Clair Kos	\$ 54,026	\$ 2,804	\$ (2,804)	\$ 54,026
HPH Chair	1,590,886	82,565	(82,565)	1,590,886
General	1,411,627	73,544	(73,269)	1,411,902
Rupley Fellowship	250,000	12,974	(12,974)	250,000
Library	376,561	19,543	(19,543)	376,561
Electron microscope	500,000	25,950	(25,950)	500,000
Kenneth & Charity Ritter	82,500	4,282	(4,282)	82,500
Permanent capital	2,312,872	120,036	(120,036)	2,312,872
J House	14,098	14,582	(1,082)	27,598
CC Levine Research	1,502,127	77,959	(77,959)	1,502,127
CARE Center	50,000	2,595	(2,595)	50,000
LEID	1,000,000	51,899	(51,899)	1,000,000
Hearst Lab Internship	300,000	15,570	(15,570)	300,000
Lied Children's Center	1,000,000	51,899	(51,899)	1,000,000
Kenneth & Charity Ritter	-	169,281	(4,281)	165,000
William Slattery	-	10,260	(260)	10,000
McLoraine	-	1,025,950	(25,950)	1,000,000
Caruso Endowment	-	120,358	(648)	119,710
Total Permanently Restricted Net Assets	\$ 10,444,697	\$ 1,882,051	\$ (573,566)	\$ 11,753,182

HOUSE EAR INSTITUTE
SCHEDULE OF CHANGES IN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2003
(Continued)

	2002	Donations Income and Transfers	Expenditures and Transfers	2003
Temporarily Restricted Net Assets				
Star-2002 International Hearing Aid Research Conference	\$ -	\$ 3,490	\$ (3,490)	\$ -
Online Hearing Screening Tests	-	2,000	(251)	1,749
Ahmanson Imaging Equipment	12,836	-	(3,951)	8,885
Guenther Foundation	143,120	-	(289)	142,831
Bundy Foundation	18,115	100,000	-	118,115
Taper Foundation-Children's Program	273,255	-	(130,654)	142,601
Western Lion's Fund - Travel	-	1,030	(598)	432
Western Lion's Fund	-	740	(13)	727
Caruso (Genetic Hearing Loss)	-	359,779	-	359,779
Microscope Upkeep	138,884	25,950	(22,696)	142,138
General - Time Restricted	372,936	445,408	-	818,344
Research Initiative	167,216	26,500	-	193,716
Rupley Fellows	4,483	12,975	-	17,458
Hearst Lab Interns	7,485	15,570	(5,577)	17,478
Quota Fellows	12,099	-	-	12,099
MIS Digital Imaging	325,000	-	(284,912)	40,088
Unitrusts & Pooled Income Funds	811,223	14,767	-	825,990
Jameson Laboratory Fund	3,400	-	-	3,400
Educational Grants	12,700	-	-	12,700
Herklotz-Education/Outreach	245,797	-	-	245,797
Building Fund	4,632,582	123,213	(1,449,919)	3,305,876
Graziadio Education/Outreach Program	282,832	-	(4,066)	278,766
CARE Operations	-	641,339	(498,829)	142,510
CMB Research	-	126,941	(126,941)	-
Family Camp	-	18,350	(18,350)	-
Sound Partners	-	84,593	(33,365)	51,228
Skirball-Novel Therapies	250,000	-	(250,000)	-
Care Clinic Research	-	20,000	-	20,000
Jan Doak Building Fund	295,593	-	-	295,593
David Lim Fund	-	4,000	-	4,000
Howard House Clinical Studies Lab	-	138,849	-	138,849
Ritter Endowment Earnings	-	8,563	-	8,563
William Slattery Endowment Earnings	-	259	-	259
McLoraine Endowment Earnings	-	25,949	-	25,949
Hearing Aid Research Fund	-	750	-	750
Audiovisual Department Fund	-	4,420	-	4,420
Cochlear Implant Fund	-	3,750	-	3,750
General Research Fund	-	61,225	-	61,225
Underwriter Fund	-	26,000	-	26,000
Public Forum Fund, May 2003	-	7,000	-	7,000
Egyptian Cultural & Education Bureau	-	5,723	(566)	5,157
Total Temporarily Restricted Net Assets	\$ 8,009,556	\$ 2,309,133	\$ (2,834,467)	\$ 7,484,222

**HOUSE EAR INSTITUTE
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2003**

HEI Project Number	Federal Grantor/Pass-through Grantor Program Title	Federal Catalog Number	Agency or Pass- through Number	Contract Period	Expenditures
527	Department of Defense	12.420	DAMD 17-99-1-9491	10/01/99-09/30/04	\$ 13,685
569	Department of Defense	12.420	DAMD17-01-1-0710	01/01/02-12/31/04	655,356
506	National Science Foundation	47.075	IIS9996088	10/15/98-09/30/03	269,427
534	National Science Foundation	47.075	BCS-0083865	09/15/00-08/31/03	6,923
761	National Science Foundation	47.075	BCS-214224	08/01/02-07/31/04	87,021
Pass-through from National Institutes of Health					
501	National Institute on Deafness & Other Communication Disorders	93.173	R29 DC03552	08/01/98-07/31/03	71,760
502	National Institute on Deafness & Other Communication Disorders	93.173	RO3 DC04237	08/01/99-01/31/03	52,331
509	National Institute on Deafness & Other Communication Disorders	93.173	RO1 DC00695	07/01/88-08/31/02	46,016
524	National Institute on Deafness & Other Communication Disorders	93.173	RO1 DC04189	08/01/99-07/31/04	275,652
528	National Institute on Deafness & Other Communication Disorders	93.173	RO1 DC04061	09/01/99-08/31/04	306,396
529	National Institute on Deafness & Other Communication Disorders	93.173	RO1 DC03592	04/01/00-03/31/04	225,831
531	National Institute on Deafness & Other Communication Disorders	93.173	R21 DC04492	05/01/00-10/31/02	1,538
532	National Institute on Deafness & Other Communication Disorders	93.173	RO1 DC04562	07/01/00-06/30/05	355,726
538	National Institute on Deafness & Other Communication Disorders	93.173	RO1 DC04675	03/01/01-02/28/06	252,863
539	National Institute on Deafness & Other Communication Disorders	93.173	RO1 DC04709	01/15/01-12/31/05	313,136
555	National Institute on Deafness & Other Communication Disorders	93.173	RO1 DC04993	07/01/01-05/31/06	225,604
556	National Institute on Deafness & Other Communication Disorders	93.173	RO1 DC05025	09/01/01-08/31/04	343,877
558	National Institute on Deafness & Other Communication Disorders	93.173	F32 DC05282	09/01/01-08/31/05	22,143
559	National Institute on Deafness & Other Communication Disorders	93.173	RO1 DC04796	09/28/01-08/31/06	457,952
560	National Institute on Deafness & Other Communication Disorders	93.173	RO3 DC04759	02/09/01-01/31/04	64,555
572	National Institute on Deafness & Other Communication Disorders	93.173	RO1 DC4856	05/01/01-04/30/06	253,315
574	National Institute on Deafness & Other Communication Disorders	93.173	R21 DC04876	05/01/01-04/30/04	72,853
588	National Institute on Deafness & Other Communication Disorders	93.173	F33 DC05289	01/01/02-07/31/02	3,770
597	National Institute on Deafness & Other Communication Disorders	93.173	RO1 DC04792	05/01/01-04/30/06	270,284
750	National Institute on Deafness & Other Communication Disorders	93.173	RO3 DC05566	03/01/02-02/28/05	75,630
751	National Institute on Deafness & Other Communication Disorders	93.173	RO1 DC04786	04/01/02-03/31/07	179,728
752	National Institute on Deafness & Other Communication Disorders	93.173	1U13 DC05433	08/21/02-07/31/03	34,821
753	National Institute on Deafness & Other Communication Disorders	93.173	RO1 DC01526	04/15/02-03/31/07	337,904
758	National Institute on Deafness & Other Communication Disorders	93.173	RO1 DC05220	07/01/02-06/30/05	261,347
759	National Institute on Deafness & Other Communication Disorders	93.173	RO3 DC05335	07/05/02-06/30/05	29,780
762	National Institute on Deafness & Other Communication Disorders	93.173	RO1 DC05213	08/01/02-06/30/07	176,444
763	National Institute on Deafness & Other Communication Disorders	93.173	RO1 DC05843	09/20/02-08/31/07	205,838
767	National Institute on Deafness & Other Communication Disorders	93.173	F32 DC006154	01/01/03-12/31/05	21,248
773	National Institute on Deafness & Other Communication Disorders	93.838	RO1 HL070293	04/01/03-03/31/07	14,016
774	National Institute on Deafness & Other Communication Disorders	93.173	R21 DC006139	04/01/03-03/31/05	14,349
778	National Institute on Deafness & Other Communication Disorders	93.173	RO1 DC006185	05/15/03-04/30/07	9,195
514	Pass-through from American Otolaryngology Head & Neck Surgery Foundation Inc. - AAOHNS Clinical Trials Cooperative Group	93.173	UO1 DC03209	04/01/97-03/31/03	18,320
557	Pass-through from Huntington Medical Research Institutes - A Cochlear Nucleus Auditory Prosthesis Based on Microstimulation	93.173	NO1 DC1-2105	06/30/01-06/29/04	83,104
568	Pass-through from Biologic Systems Corp. - Screening Devise for Detecting Small Acoustic Tumors	93.173	R44 DC04141	09/20/01-08/31/03	221,356
599	Pass-through from University of California at Los Angeles - Auditory Development in Early Amplified Children	93.173	1712GCB979	01/01/02-08/31/05	152,027
634	Pass-through from Indiana University - Comparison of Sensory Aids in Deaf Children	93.173	RO1 DC00064	04/01/01-03/31/05	42,263
769	Pass-through from Massachusetts General Hospital - Genotype Phenotype Relationship in Neurofibromatosis 2	93.853	RO1 NS40527	09/20/02-07/31/06	14,019
752	Veterans Administration		M020822401	08/21/02-07/31/03	8,344
754	Pass-through from Johns Hopkins University - Childhood Development after Cochlear Implantation	93.173	8206 00394X	05/01/02-04/30/07	191,528
					<u>\$ 6,739,275</u>

**HOUSE EAR INSTITUTE
NOTES TO THE SCHEDULE OF FEDERAL FINANCIAL ASSISTANCE
FOR THE YEAR ENDED JUNE 30, 2003**

Note 1 - Significant Accounting Policies

Basis of Presentation

The accompanying Schedule of Federal Financial Assistance includes all federal grants to House Ear Institute (Institute) which had activity during fiscal 2003. The schedule has been prepared on the accrual basis of accounting. Grant revenues are recorded for financial reporting purposes when the Institute has met the qualifications for the respective grants.

Accrued Reimbursement

Various reimbursement procedures are used for federal awards received by the Institute. Consequently, timing differences between expenditures and program reimbursements can exist at the beginning and end of the year. Accrued balances at year-end represent an excess of reimbursable expenditures over cash receipts to date. Generally, accrued balances caused by differences in the timing of cash receipts and expenditures will be reversed in the remaining grant period. No amounts have been accrued in excess of the stated contract amount under the grant.

Note 2 - Scope of the Audit Pursuant to OMB Circular A-133

All federal grant operations of the Institute are included in the scope of the Circular A-133 audit (Single Audit). The Single Audit was performed in accordance with the provisions of the Office of Management and Budget's Compliance Supplement for Audits of Institutions of Higher Learning and Other Nonprofit Institutions. Compliance testing of all general requirements, as described in the Compliance Supplement, was performed for the Institute.

Note 3 - Reconciliation of Schedule of Federal Assistance

The Institute is currently receiving several grants through other nonprofit organizations as a subrecipient. These grants are not included in the Schedule of Federal Financial Assistance. Below is the reconciliation of the reportable Schedule of Financial Assistance to the Institute's audited financial statements.

Total Grant Expenditures per Schedule of Federal Financial Assistance	\$ 6,739,275
Other Grants	
National Organization for Hearing Research Foundation	415,529
Medical Research Products	92,641
Otologies	75,664
Deafness Research Foundation	50,851
Cochlear Americas Inc.	38,173
March of Dimes	34,664
Miscellaneous consulting	<u>70,740</u>
 Total Grants and Contracts Revenue per Audited Financial Statements	 <u><u>\$ 7,517,537</u></u>

SINGLE AUDIT



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

To the Board of Directors
House Ear Institute

We have audited the financial statements of House Ear Institute as of and for the year ended June 30, 2003, and have issued our report thereon dated September 23, 2003. We conducted our audit in accordance with generally accepted auditing standards 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 House Ear Institute'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 House Ear Institute'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.

This report is intended for the information of the audit committee, management, federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.

September 23, 2003



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

To the Board of Directors
House Ear Institute

Compliance

We have audited the compliance of House Ear Institute 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 June 30, 2003. House Ear Institute'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 House Ear Institute's management. Our responsibility is to express an opinion on House Ear Institute's compliance based on our audit.

We conducted our audit of compliance in accordance with U. S. generally accepted auditing standards; 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 House Ear Institute'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 on House Ear Institute's compliance with those requirements.

In our opinion, House Ear Institute 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 June 30, 2003.

Internal Control Over Compliance

The management of House Ear Institute is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered House Ear Institute'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 internal control over compliance in accordance with OMB Circular A-133.

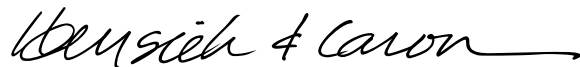
Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the

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.

Schedule of Expenditures of State and Federal Awards

We have audited the basic financial statements of House Ear Institute as of and for the year ended June 30, 2003, and have issued our report thereon dated September 23, 2003. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Schedule of Expenditures of State and Federal Awards is presented for purposes of additional analysis as required by OMB Circular A-133 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.

This report is intended for the information of the audit committee, management, federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.



September 23, 2003

**HOUSE EAR INSTITUTE
STATUS OF FINDINGS AND QUESTIONED COSTS
JUNE 30, 2003**

A. SUMMARY OF AUDIT RESULTS

1. The auditor's report expresses an unqualified opinion on the basic financial statements of the House Ear Institute
2. No reportable conditions were disclosed during the audit of the financial statements.
3. No instances of noncompliance material to the financial statements of House Ear Institute were disclosed during the audit.
4. The auditor's report on compliance for the major federal award programs for House Ear Institute expresses an unqualified opinion.
5. The programs tested as major programs included:

<u>Name of Program</u>	<u>CFDA Number</u>
Research and Development Cluster	93.173

6. The threshold for distinguishing type A and B programs was \$300,000.
7. House Ear Institute was determined to be a high-risk auditee.

B. FINDINGS – FINANCIAL STATEMENTS AUDIT

None

**C. FINDINGS AND QUESTIONED COSTS – MAJOR FEDERAL AWARD PROGRAMS
AUDIT**

None

**HOUSE EAR INSTITUTE
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2003**

None

**HOUSE EAR INSTITUTE
SCHEDULE OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2003**

1. PRIOR YEAR FINDINGS AND QUESTIONED COSTS – MAJOR FEDERAL AWARD PROGRAMS AUDIT

02-1

Finding: The overall controls and process are not working effectively within the Institute's finance department. As such, many important functions are not completed in a timely and effective manner or are not completed at all.

Recommendation: A thorough review of all processes and controls in place at the Institute should be undertaken. Based on the results of this review, procedures should be put in place and documented to provide for consistency of the operations and adherence to sound internal control.

Status of prior year findings: The Institute has implemented changes to existing controls to ensure compliance with laws and regulations applicable to federal programs. They have conducted in-service training and will provide education and training on an on-going basis. The following occurred during the year:

- All users were fully trained on the internal accounting system as it pertained to their position. Cross training is in process, which will provide wider departmental systems knowledge.
- Financial management has a working knowledge of FASB 116, and in-house staff training was provided for the accounting staff.
- Pledge receipts and payments are reconciled on a monthly basis between the finance department and the development department.
- The cost basis of investments is reconciled on a monthly basis to broker statements.
- All accounting entries are currently signed-off by the controller. Entries prepared by the controller are signed-off by the CFO.
- All capital items are tagged and reconciled between the physical inventory and the accounting record. Additionally, policies and procedures have been written to fully comply with the requirements of OMB Circular A-110.
- The cash reconciliation function was separated from the deposit and posting of patient cash.

02-2

Finding: In testing the Institute's indirect cost rate proposal submitted to the respective federal agency, we noted an amount related to the provision for bad debt was included in the indirect cost rate calculation. Such costs are unallowable under the provisions of OMB Circular A-122.

Recommendation: The Institute should implement policies and procedures relevant to the preparation and review of the indirect cost rate proposal to ensure that unallowable costs are not included in the calculation of indirect cost rates.

Status of prior year findings: A member of senior management reviews the indirect cost proposal prior to submission. It was noted that the provision for bad debt was not included in the 2003 indirect cost proposal.

HOUSE EAR INSTITUTE
SCHEDULE OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2003
(Continued)

02-3

Finding: No property and equipment management system is currently in place. Additionally, the Institute has not conducted a physical inventory count of its fixed assets financed with federal funds within the last two years.

Recommendation: Management should implement a property and equipment management system that will effectively track its property and equipment, including policies required under OMB Circular A-110.

Status of prior year findings: During the year the finance department implemented a fixed asset program that tracks the assets by program. It also integrates with the general ledger. It was noted that the finance policies and procedures of the Institute require a bi-annual physical inventory of fixed assets.

02-04

Finding: The Institute does not maintain written policies and procedures for the procurement of federally financed goods and services as established in sections .40-.48 of OMB Circular A-110. Those standards require the Institute to establish and maintain written procurement procedures that include standards of conduct governing the performance of its employees engaged in the award and administration of contracts.

Recommendation: The Institute should develop and maintain a formalized procurement policies and procedures manual.

Status of prior year findings: Comprehensive procurement policies and procedures have been written and implemented. These policies and procedures comply with the requirements of OMB Circular A-110.

02-05

Finding: The Institute often times does not submit quarterly or grant close-out reports as required by the granting agency. Such reports are not always submitted timely or submitted at all (project 587). In addition, we noted that there is no formal review by anyone other than the preparer of financial reports submitted to the related federal or pass-through agency.

Recommendation: The Institute should implement the appropriate procedures to ensure that related financial and programmatic reports are submitted timely and properly reviewed prior the submission.

Status of prior year findings: A schedule was developed to track all due dates of quarterly PMS-272 "Federal Cash Transaction Report" and grant closeout reports, FSR-269a. These reports were reviewed by senior management prior to submission. Based on tests performed the PMS-272 and FSR-269a's were filed timely for the year ended June 30, 2003.

HOUSE EAR INSTITUTE
SCHEDULE OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2003
(Continued)

02-06

Finding: The Institute currently does not maintain internal controls over the accounting and reporting of interest earned on advanced funds in accordance with provisions of OMB Circular A-100 Section 22.

Recommendation: The Institute should implement the appropriate procedures over the receipts and disbursement of federal cash draws, including the accounting and reporting of interest earned on advanced funds

Status of prior year findings: The Institute began to draw funds in a cost reimbursement method, whereby costs are expended before the funds are requested. Therefore interest earned is no longer an issue.