Client Advisory Comments

The Tech Museum of Innovation

Year ended December 31, 2002

Grant Thornton

ountants and Business Advisors

April 25, 2003

To the Finance Committee
The Tech Museum of Innovation

In planning and performing our audit of the financial statements of The Tech Museum of Innovation (the "Organization") for the year ended December 31, 2002, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on internal control.

However, during our audit we became aware of several matters that are opportunities for strengthening internal control and operating efficiency. The memorandum that accompanies this letter summarizes our comments and suggestions regarding those matters. The matters discussed herein are those that we have noted as of April 25, 2003 and we have not updated our procedures regarding these matters since that date to the current date.

We have previously discussed our observations and suggestions with various Organization personnel and would be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations. This memorandum is intended solely for the information and use of board of directors, management, and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

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The Tech Museum of Innovation

CLIENT ADVISORY COMMENTS

Year ended December 31, 2002

CURRENT YEAR COMMENTS:

Contributions

Tracking and Reconciling Contributions and Temporarily Restricted Net Assets

- The Organization has a database of contributions received, receivable and collected via the Blackbaud/Razor's Edge software maintained by the development department. This database is very important to the finance department because it serves as the method to communicate the existence of contributions, pledges, pledge payments and any donor-imposed restrictions. We noted that the data in this database is not reconciled to contribution data recorded in the general ledger on a regular basis and much of it is reconciled only at the end of the year. This reconciliation was still ongoing during our audit fieldwork.

- Contribution accounting in the general ledger is maintained on a cash basis during the year and converted to an accrual basis as part of the year end close. As a result, the pledges receivable and revenue recognition in the interim months does not conform with generally accepted accounting principles.

- The finance department tracks temporarily restricted net assets (unused donor-restricted funds) in a spreadsheet which rolls-forward restricted activity, by donor, from month to month. While this reconciliation had been maintained, we noted that the associated general ledger accounts had not been updated to reflect that activity when we commenced the audit. We were also informed that the data in that reconciliation was inconsistent with the data reported to the financial committee. The accuracy of temporarily restricted net asset accounting and reporting is especially critical to The Tech in the current environment when the Organization is borrowing those restricted monies to fund current operations. The extent of borrowing and the repayment plans must be accurately tracked and that cannot be done without having accurate information about the extent of temporarily restricted net assets.

  We recommend that Organization begin reconciling the donor database to the general ledger on a monthly basis. We also suggest recording contribution general ledger activity on an accrual basis not only at the end of the year, but also during the year. Management has expressed a desire to report all interim financial data on an accrual basis so this change would facilitate that initiative. Finally, we recommend that the receipt and use of donor-restricted funds be recorded in the associated general ledger accounts each month and that extra care be taken to report accurate temporarily restricted net asset balances and borrowing to the finance committee.

Unconditional vs. Conditional Promises to Give/Revenue Recognition

Statement of Financial Accounting Standards No. 116, *Accounting for Contributions Received and Contributions Made*, calls for organizations to record as assets and revenue, "unconditional promises to give," commonly referred to as pledges receivable. SFAS 116 states that in cases of ambiguous donor stipulations, a promise containing stipulations that are not clearly unconditional shall be presumed to be a conditional promise and therefore not recognized as contribution revenue until the condition has been substantially met. This distinction is becoming more and more relevant to The Tech and other not-for-profit organizations in the current environment. Due to current economic conditions, some donors are qualifying their existing commitments as well as new contributions with such wording as "it is our *intent* to give these funds... " or "we commit these funds to the Organization *subject to*... ". We encountered just such a situation at The Tech during the audit which required consulting with the donor for further clarification.

> We recommend that the Organization carefully review donor correspondence for such conditional wording and encourage management to contact (preferably in written form) the donor in these situations to further clarify the donor's commitment before recording revenue. We also recommend The Tech consider strengthening the wording in its existing pledge forms and using the phrase, "unconditional promise to give."

Borrowing Donor-Restricted Funds

The Organization's unrestricted net assets have been diminishing for several years. To help pay for operational expenses, the Organization has borrowed from its donor-restricted funds.

> We strongly encourage the Organization to seek other sources of cash to fund operations. Borrowing from funds restricted by donors for other purposes can be considered a violation of the donor's restriction unless that borrowing was done with the permission of the donor(s). A donor always has the option to ask for their donation back if it has not been used in accordance with their wishes. We have noted that management has a plan in place to reduce this type of borrowing in forthcoming year and we encourage The Tech to keep this initiative a top priority.

Opportunity for Increased Efficiencies Within the Accounting Department

The Organization maintains certain sub-ledgers and reports using Excel, such as the fixed asset and accounts payable sub-ledgers and summarized financial reports, among others. Although Excel is a very useful tool, the Organization should utilize their accounting software to maintain these sub-ledgers and prepare reports. The accounting software should be integrated with the sub-ledgers and have report writing capabilities. The manual system currently being used can be time consuming and prone to errors.

> The general ledger system, American FundWare, is equipped to run certain reports (i.e. accounts payable aging and others). By utilizing these features in American FundWare, reports can be processed on a more efficient and timely manner. Another alternative is to purchase a new accounting package or upgrade to the current version of the existing package so that it can better suit the Organization's needs. While the current package functions, it is an older DOS-based system which is not efficient.

Computer Environment/Segregation of Duties

Within the finance department, employees are given a unique computer user identification number, but only one password is established amongst all users. Additionally, access to different components of the general ledger system is not segregated between the employees. This allows any employee to enter any component of the general ledger system, which may encourage fraud and risk of potential misstatements when posting transactions into the general ledger.

> Management should establish user rights within the accounting software for each accounting personnel and should be issued unique passwords to aid in restricting access to incompatible duties.

The Tech Museum of Innovation

CLIENT ADVISORY COMMENTS (continued)

Year ended December 31, 2002

STATUS OF PRIOR YEAR COMMENTS:

Federal Grants

We understand the Organization recently has been awarded some grants from the National Science Foundation that will benefit fiscal 2002 and future periods. As you are aware, federally funded grants come with many restrictive rules and regulations regarding allowability of costs, employee time reporting requirements, involved overhead rate and fringe benefit rate applications and reporting, among other things. When expenditures of federal monies exceed $300,000 in a fiscal year, compliance with theses rules and regulations must be tested as part of the annual audit in accordance with the Single Audit Act Amendments of 1996 and OMB Circular A-133, *Audits of States, Local Governments, and Non-for-Profit Organizations.*

Being that the Organization has not had a large volume of federal grants in the recent past yet sees this revenue source as a significant opportunity for the future, we recommend the Organization establish an infrastructure to administer a grants management function. In its early stages, this would involve designating an existing employee as the grants management specialist, providing some training regarding OMB Cost Circulars and other federal regulations and establishing an internal control environment to ensure compliance. As the volume of grants increases, this function may become a full-time position. We would be happy to recommend certain training courses and resource manuals that should facilitate this process.

Current Status:

This recommendation has not been implemented.

Payroll Processing

It was observed that the payroll accountant sets up employees and transmits bi-weekly payroll to the service provider. This same individual also receives the bi-weekly payroll summary reports and payroll checks, and direct deposit advices directly from the service provider.

There appears to be a lack of segregation of duties with the payroll cycle. We recommend someone other than the individual responsible for preparing the payroll and recording payroll entries, actually receive payroll checks for distribution. We also recommend that a formal process be developed whereby changes to employee information submitted to ADP (e.g., salary, name, address) are approved by someone other than the individual responsible for processing payroll.

Current Status:

This recommendation has not been implemented.

The Tech Museum of Innovation

CLIENT ADVISORY COMMENTS (continued)

Year ended December 31, 2002

Application of Cash Receipts to Pledges Receivable

During our testing of contributions, we noted three instances in which the Organization wrote-off as bad debt expense, pledges receivable in 2001 that were collected in cash from donors in 2000. These cash receipts of approximately $98,000 were not applied to pledges in 2000, but instead were recorded as contribution revenue in that year.

Current Status:

We encountered no similar errors in the 2002 audit.

Recognition of Unrealized Investment Gains and Losses

During our testing of investments, we noted that unrealized gains and losses on investments were not recorded as of year-end. This was corrected via an audit adjusting journal entry.

Current Status:

This recommendation has been implemented.