

Financial Statements

HOUSE EAR INSTITUTE

June 30, 2010



HENSIEK & CARON

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INDEPENDENT AUDITOR'S REPORT

To The Board of Trustees
House Ear Institute

We have audited the accompanying statement of financial position of House Ear Institute, a nonprofit corporation, as of June 30, 2010, and the related statement of activities and changes in net assets, cash flow, 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 prior year summarized comparative information has been derived from House Ear Institute's 2009 financial statements and, in our report dated October 23, 2009, we expressed an unqualified opinion on those financial statements.

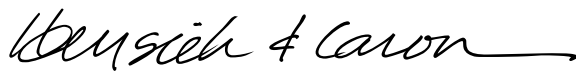
We conducted our audit in accordance with U.S. generally accepted auditing standards, and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of House Ear Institute, as of June 30, 2010, 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.

The accompanying financial statements have been prepared assuming that the Organization will continue as a going concern. As discussed in note 19 to the financial statements, the Organization has suffered recurring deficits, and has been unable to meet debt covenants, that raise substantial doubt about its ability to continue as a going concern. Management's plans regarding these matters are also described in note 19. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 22, 2010, on our consideration of House Ear Institute's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements of House Ear Institute taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with U.S. generally accepted auditing standards. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.



October 22, 2010

HOUSE EAR INSTITUTE
STATEMENTS OF FINANCIAL POSITION
JUNE 30, 2010 AND 2009

ASSETS

	2010	2009
Assets		
Cash	\$ 655,095	\$ 656,730
Bequests and other donations receivable	2,031,932	2,189,150
Accounts receivable, net	1,996,197	1,426,494
Educational and research supplies	33,736	54,556
Prepaid expenses and other assets	9,050	12,805
Pledges receivable	2,209,016	3,873,779
Notes receivable	303,651	350,785
Investments	7,350,635	16,262,255
Assets of split-interest agreements	1,228,371	1,220,303
Patent development costs	38,229	38,229
Patent costs	92,743	105,725
Deferred bond costs, net	919,118	654,325
Facilities and equipment, at cost, net	43,100,073	46,585,907
Total Assets	\$ 59,967,846	\$ 73,431,043

LIABILITIES AND NET ASSETS

Liabilities		
Accounts payable and accrued expenses	\$ 1,504,516	\$ 1,914,585
Accrued interest payable	72,471	126,170
Notes payable and line of credit	-	3,700,000
Deferred revenue	379,181	308,081
Liability to beneficiaries under split-interest agreements	610,508	846,936
Deferred revenue - pooled income fund	36,823	38,363
Bonds payable	29,910,000	29,910,000
Total Liabilities	32,513,499	36,844,135
Net Assets		
Unrestricted	6,645,207	15,816,987
Temporarily restricted	6,608,893	6,569,674
Permanently restricted	14,200,247	14,200,247
Total Net Assets	27,454,347	36,586,908
Total Liabilities and Net Assets	\$ 59,967,846	\$ 73,431,043

HOUSE EAR INSTITUTE
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2010
WITH SUMMARIZED INFORMATION FOR THE YEAR ENDED JUNE 30, 2009

	2010			2009	
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
Public Support and Revenue					
Contributions	\$ 2,119,814	\$ 1,400,058	\$ -	\$ 3,519,872	\$ 9,898,138
Grants and contracts - direct	6,045,980	-	-	6,045,980	4,440,251
Grants and contracts - indirect	3,530,151	-	-	3,530,151	2,900,479
Special events	297,500	-	-	297,500	161,696
Educational courses	108,630	-	-	108,630	114,760
Investment returns, net	798,175	-	-	798,175	(1,454,434)
Building operations	627,452	-	-	627,452	608,120
Clinical services	1,246,504	-	-	1,246,504	956,312
Royalties	378,052	-	-	378,052	132,397
Other	399,453	-	-	399,453	744,612
Change in value of split-interest agreements	-	246,036	-	246,036	(325,872)
Net assets released from restrictions	1,606,875	(1,606,875)	-	-	-
Total Public Support and Revenue	17,158,586	39,219	-	17,197,805	18,176,459
Expenses					
Program Services					
Research	16,899,207	-	-	16,899,207	16,504,430
Education	686,289	-	-	686,289	853,325
Total Program Services	17,585,496	-	-	17,585,496	17,357,755
Supporting Services					
Management and general	6,135,247	-	-	6,135,247	6,184,954
Fund raising	1,155,946	-	-	1,155,946	1,160,089
Total Supporting Services	7,291,193	-	-	7,291,193	7,345,043
Total Expenses Before Debt Service Costs	24,876,689	-	-	24,876,689	24,702,798
Change in Net Assets Before Debt Service Costs	(7,718,103)	39,219	-	(7,678,884)	(6,526,339)
Debt Service Costs	1,453,677	-	-	1,453,677	1,562,016
Change in Net Assets	\$ (9,171,780)	\$ 39,219	\$ -	\$ (9,132,561)	\$ (8,088,355)

**HOUSE EAR INSTITUTE
STATEMENTS OF CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2010 AND 2009**

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Net Assets, June 30, 2008	\$ 22,407,109	\$ 8,068,085	\$14,200,069	\$ 44,675,263
Change in Net Assets	<u>(6,590,122)</u>	<u>(1,498,411)</u>	<u>178</u>	<u>(8,088,355)</u>
Net Assets, June 30, 2009	15,816,987	6,569,674	14,200,247	36,586,908
Change in Net Assets	<u>(9,171,780)</u>	<u>39,219</u>	<u>-</u>	<u>(9,132,561)</u>
Net Assets, June 30, 2010	<u>\$ 6,645,207</u>	<u>\$ 6,608,893</u>	<u>\$ 14,200,247</u>	<u>\$ 27,454,347</u>

**HOUSE EAR INSTITUTE
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2010 AND 2009**

	2010	2009
Cash Flows from Operating Activities		
Cash received from service recipients	\$ 11,266,154	\$ 9,646,156
Cash received from donors	5,639,353	7,239,880
Cash received from building operations, net	571,465	611,040
Cash paid to suppliers and employees	(21,842,572)	(21,155,720)
Interest and dividends received	153,885	336,591
Interest and other debt service costs paid	(1,507,376)	(1,513,477)
Net Cash Used in Operating Activities	(5,719,091)	(4,835,530)
Cash Flows from Investing Activities		
Additions to facilities and equipment	(217,544)	(4,522,308)
Proceeds from sale of facilities and equipment	-	342,621
Purchases of investments	(5,873,954)	(23,480,469)
Proceeds from sale of investments	15,461,818	27,997,124
Collections on loans	47,136	178,988
Net Cash Provided by Investing Activities	9,417,456	515,956
Cash Flows from Financing Activities		
Proceeds from donations and investment earnings restricted for:		
Endowment	-	178
Proceeds from line of credit	-	1,700,000
Payments on notes payable and line of credit	(3,700,000)	-
Net Cash (Used in) Provided by Financing Activities	(3,700,000)	1,700,178
Net Decrease in Cash	(1,635)	(2,619,396)
Cash, Beginning	656,730	3,276,126
Cash, Ending	\$ 655,095	\$ 656,730

HOUSE EAR INSTITUTE
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2010 AND 2009
(Continued)

	<u>2010</u>	<u>2009</u>
Reconciliation of the Change in Net Assets		
To Net Cash Used in Operating Activities		
Change in Net Assets	\$ (9,132,561)	\$ (8,088,355)
Adjustments to reconcile the change in net assets to net cash used in operating activities		
Change in allowance for uncollectible accounts	128,027	50,850
Change in present value of pledges receivable	(71,487)	124,065
Depreciation and amortization	3,297,133	2,983,366
Net realized and unrealized losses on investments	(676,246)	1,734,996
Change in value of split-interest agreements	(246,036)	355,065
Loss on disposition of property and equipment	472,497	245,070
Donations of noncash assets	-	(45,534)
(Increase) Decrease in:		
Donations receivable	157,218	(670,000)
Accounts receivable	(697,730)	258,283
Educational and research supplies	20,820	(2,462)
Pledges receivable	1,736,250	(2,257,500)
Prepaid expenses and other assets	3,755	32,309
Deferred bond costs	(318,063)	-
Increase (Decrease) in:		
Accounts payable and accrued expenses	(410,069)	344,824
Accrued bond interest payable	(53,699)	48,539
Other deferred revenue	71,100	51,132
Donations restricted for long-term purposes:		
Cash donations	-	(178)
	<u> </u>	<u> </u>
Net Cash Used in Operating Activities	<u>\$ (5,719,091)</u>	<u>\$ (4,835,530)</u>

HOUSE EAR INSTITUTE
STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED JUNE 30, 2010
WITH SUMMARIZED INFORMATION FOR JUNE 30, 2009

	2010						2009	
	Program Services			Supporting Services			Total Expenses	Total Expenses
	Research	Education	Total	Management and General	Fund Raising	Total		
Salaries and wages	\$ 8,248,161	\$ 265,892	\$ 8,514,053	\$ 2,293,911	\$ 658,493	\$ 2,952,404	\$ 11,466,457	\$ 12,604,643
Taxes and employee benefits	1,676,553	53,710	1,730,263	411,496	133,016	544,512	2,274,775	2,925,749
Total Personnel Costs	9,924,714	319,602	10,244,316	2,705,407	791,509	3,496,916	13,741,232	15,530,392
Professional fees and contract service payments	1,642,626	110,456	1,753,082	481,402	100,937	582,339	2,335,421	1,412,830
Occupancy and related expenses	1,058,086	34,598	1,092,684	511,143	31,920	543,063	1,635,747	1,754,055
Travel, conferences, conventions and meetings	208,435	61,765	270,200	104,166	30,556	134,722	404,922	355,376
Special supplies and services	831,640	62,404	894,044	39,395	22,245	61,640	955,684	992,029
Cost of goods sold	344,093	1,191	345,284	-	-	-	345,284	458,435
Minor equipment and equipment maintenance	255,168	138	255,306	685,286	400	685,686	940,992	437,562
Office supplies and services	249,158	25,040	274,198	940,405	71,923	1,012,328	1,286,526	814,966
Total Expenses Before Depreciation	14,513,920	615,194	15,129,114	5,467,204	1,049,490	6,516,694	21,645,808	21,755,645
Depreciation - building	1,618,224	60,626	1,678,850	537,661	62,678	600,339	2,279,189	1,938,145
Depreciation - equipment and furniture	767,063	10,469	777,532	130,382	43,778	174,160	951,692	1,009,008
Total Depreciation	2,385,287	71,095	2,456,382	668,043	106,456	774,499	3,230,881	2,947,153
Total Expenses Before Debt Service Costs	<u>\$ 16,899,207</u>	<u>\$ 686,289</u>	<u>\$ 17,585,496</u>	<u>\$ 6,135,247</u>	<u>\$ 1,155,946</u>	<u>\$ 7,291,193</u>	<u>\$ 24,876,689</u>	<u>\$ 24,702,798</u>

HOUSE EAR INSTITUTE
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010

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, 2010

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.

Accounts Receivable

Accounts receivable are stated at unpaid balances, less an allowance for doubtful accounts. The Institute provides for losses on accounts receivable using the allowance method. The allowance is based on experience, third-party contracts, and other circumstances. Receivables are considered impaired if full principal payments are not received in accordance with the contractual terms. It is the Institute's policy to charge off uncollectible accounts receivable when management determines the receivable will not be collected.

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. It is the Institute's policy to capitalize expenditures for these items in excess of \$5,000. Depreciation is provided, using the straight-line method, over the following estimated useful lives:

Medical and research facilities	30 years
Equipment and furniture	3 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.

Statement of Cash Flows

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

HOUSE EAR INSTITUTE
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010

Note 1 - Summary of Significant Accounting Policies (continued)

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, 2009.

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 – Cash

Cash balances restricted for building upkeep and maintenance for the years ended June 30, 2010 and 2009 were \$0 and \$144,911, respectively.

Note 3 – 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 \$250,000 per institution. At June 30, 2010, the Institute's uninsured cash balance totaled \$680,779.

Note 4 – Accounts Receivable

Accounts receivable consists of the following:

	<u>2010</u>	<u>2009</u>
Accounts receivable	\$ 2,583,814	\$ 1,886,084
Less allowance for doubtful accounts	587,617	459,590
	<u>\$ 1,996,197</u>	<u>\$ 1,426,494</u>

HOUSE EAR INSTITUTE
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010

Note 5 – Patent Costs

Patent costs consist of the following:

	<u>2010</u>	<u>2009</u>
Patents costs	\$ 220,688	\$ 220,688
Less accumulated amortization	127,945	114,963
	<u>\$ 92,743</u>	<u>\$ 105,725</u>

Note 6 – Deferred Bond Costs

Deferred bond costs consist of the following:

	<u>2010</u>	<u>2009</u>
Deferred bond costs	\$ 1,014,977	\$ 696,915
Less accumulated amortization	95,859	42,590
	<u>\$ 919,118</u>	<u>\$ 654,325</u>

Note 7 – Pledges Receivable

Unconditional promises to give consist of the following:

	<u>2010</u>	<u>2009</u>
Receivable in less than one year	\$ 1,052,500	\$ 1,800,000
Receivable in one to five years	965,000	1,777,500
Receivable in more than five years	307,500	483,750
Total unconditional promises to give	2,325,000	4,061,250
Less discounts to net present value	115,984	187,471
Net unconditional promises to give	<u>\$ 2,209,016</u>	<u>\$ 3,873,779</u>

The effective interest rate for the discount on receivables due in periods after one year is based on market interest rates in effect at the time of the pledge. The rate used in 2010 and 2009 was 1.79% and 2.56%, respectively. Management believes all pledges are collectible.

	<u>2010</u>	<u>2009</u>
Restricted for:		
Building construction, maintenance and debt reduction	\$ 125,175	\$ 618,870
Specific research projects	1,760,152	2,668,649
Unrestricted	323,689	586,260
	<u>\$ 2,209,016</u>	<u>\$ 3,873,779</u>

**HOUSE EAR INSTITUTE
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010**

Note 8 – Investments

As of June 30, 2010 and 2009, investments consist of the following:

<u>2010</u>	<u>Aggregate Fair Value</u>	<u>Cost</u>
Cash and cash equivalents	\$ 37,014	\$ 37,014
Corporate stocks	458,006	385,142
Mutual funds	1,368,549	1,340,445
United States Treasury bonds and notes	5,487,066	5,444,282
	<u>\$ 7,350,635</u>	<u>\$ 7,206,883</u>

<u>2009</u>	<u>Aggregate Fair Value</u>	<u>Cost</u>
Cash and cash equivalents	\$ 560,196	\$ 560,196
Corporate stocks	1,544,848	1,420,551
Corporate bonds	887,750	894,593
Mutual funds	3,726,746	4,124,917
United States Treasury bonds and notes	9,542,715	9,522,355
	<u>\$16,262,255</u>	<u>\$16,522,612</u>

Investment returns are summarized as follows:

<u>2010</u>	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
Interest and dividends	\$ 174,426	\$ -	\$ 174,426
Net realized and unrealized losses	655,705	-	655,705
Investment fees	(31,956)	-	(31,956)
	<u>\$ 798,175</u>	<u>\$ -</u>	<u>\$ 798,175</u>

<u>2009</u>	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
Interest and dividends	\$ 336,591	\$ -	\$ 336,591
Net realized and unrealized losses	(1,734,996)	-	(1,734,996)
Investment fees	(56,029)	-	(56,029)
	<u>\$ (1,454,434)</u>	<u>\$ -</u>	<u>\$ (1,454,434)</u>

**HOUSE EAR INSTITUTE
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010**

Note 9 – 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 10 – Facilities and Equipment

Facilities and equipment consist of the following:

	<u>2010</u>	<u>2009</u>
Building	\$67,315,703	\$67,312,152
Furniture and equipment	13,740,291	13,720,069
Construction in progress	-	301,509
	<u>81,055,994</u>	<u>81,333,730</u>
Less accumulated depreciation	<u>(37,955,921)</u>	<u>(34,747,823)</u>
	<u>\$43,100,073</u>	<u>\$46,585,907</u>

Note 11 – Bonds Payable

On August 30, 2007 the Institute issued \$29,910,000 in Series 2007 California Statewide Communities Development Authority Variable Rate Demand Bonds (2007 Bonds) to fund construction of a research facility, to redeem the Institute's existing Bonds, to pay off two notes payable with accrued interest, and to pay bond issuance costs and letter of credit fees. The bonds are scheduled to mature on August 1, 2037.

HOUSE EAR INSTITUTE
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010

Note 11 – Bonds Payable (continued)

The 2007 Bonds are secured by a direct-pay letter of credit with City National Bank (“the Bank”) and, as described below, a confirming letter of credit with the Federal Home Loan Bank of San Francisco (“FHLB”). The Bank letter of credit is secured by the assets of the Institute and contains covenants which include requiring the Institute to maintain certain levels of liquidity and adjusted net asset balances. At June 30, 2010, the Institute did not meet the minimum levels of liquidity or the adjusted net asset requirement. The Bank has provided a waiver of the liquidity requirement at June 30, 2010 and for the following fiscal year, and the net asset balance requirement for the June 30, 2010 measurement date.

The 2007 Bonds carry a variable interest rate, as determined by the remarketing agent on a weekly basis, unless converted to a fixed rate at the option of the Institute (subject to certain restrictions). Interest is payable monthly. The Institute has early redemption options with prices determined by the length of the interest rate term. If any portion of the 2007 Bonds are tendered, and cannot be remarketed, they will be subject to interest at Prime plus 1% until remarketed.

The Institute entered into an interest-rate swap arrangement effective June 2, 2008 that effectively fixes the market interest rate on the 2007 Bonds at 2.91%. The notional amount of the contract as of June 30, 2010 and 2009 was \$29,910,000. The contract matures on June 1, 2013.

The Institute’s purpose in entering into the swap arrangement was to hedge against the risk of interest rate increases on the related variable rate debt. Management has determined that the derivative had no fair value at June 30, 2010 or 2009. The cash flow effect of the swap arrangement is included in interest expense on the statement of activities.

During the fiscal year ended June 30, 2009, the Bank suffered a decline in its credit rating, causing an increase in the market interest rate on the Bonds, which was not protected under the swap arrangement. In response, the Institute added additional security in the form of a confirming letter of credit with the FHLB. The confirming letter of credit enhances the credit-worthiness of the bonds and underlying security, thereby minimizing interest costs.

Interest expense incurred in connection with the bonds for the years ended June 30, 2010 and 2009 was \$1,303,624 and \$1,044,042, respectively. The interest rate in effect on outstanding bonds at June 30, 2010 and 2009 was .26% and 6.31%, respectively.

Costs related to the underwriting and issuance of the 2007 Bonds have been capitalized and are amortized over the remaining term of the bonds.

Note 12 – Notes Payable and Line of Credit

The Institute had a \$4,000,000 line of credit agreement with Mellon 1st Business Bank due November 1, 2009. The Institute was able to select an interest rate at the bank’s LIBOR rate plus 1.25% or at the bank’s prime rate less 1% on each amount advanced. The line was not renewed, and in March of 2010 the line was paid off.

Interest expense incurred in connection with the line of credit for the years ended June 30, 2010 and 2009 was \$44,084 and \$90,905, respectively.

**HOUSE EAR INSTITUTE
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010**

Note 13 – Net Assets

Restricted net assets consist of the following:

	<u>2010</u>	<u>2009</u>
Temporarily Restricted Net Assets		
Research Programs	\$ 4,942,715	\$ 5,381,639
Educational Programs	1,043,025	626,949
Future Operations	623,153	561,088
	<u>\$ 6,608,893</u>	<u>\$ 6,569,674</u>
Permanently Restricted Net Assets		
Operations	\$ 6,179,935	\$ 6,179,935
Research Programs	4,280,879	4,280,879
Building Operations	2,312,872	2,312,872
Educational Programs	1,426,561	1,426,561
	<u>\$14,200,247</u>	<u>\$14,200,247</u>

Note 14 – 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 4% 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 8% for each employee. Employer contributions for the year ended June 30, 2009 was \$740,281. As of July 1, 2009 the Institute suspended matching contributions.

Note 15 – Building Operations

The Institute's medical and research facilities is comprised of a total of 132,109 square feet. The Institute occupies approximately 81% 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 lease arrangements expire from 2010 to 2011, and generally contain options to renew at the discretion of the Institute, thereby allowing flexibility for growth. Future minimum lease payments for the next four years are as follows:

<u>Years ending June 30,</u>	
2011	\$ 506,787
2012	32,868
2013	32,868
2014	32,868
2015	32,868

**HOUSE EAR INSTITUTE
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010**

Note 16 – Fair Value Measurements

Fair Values Measured on Recurring Basis

Fair values of assets measured on a recurring basis at June 30, 2010 are as follows:

2010	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Investments	\$ 7,350,635	\$ 7,350,635	\$ -	\$ -
Assets of split- interest agreements	1,228,371	1,228,371	-	-
	<u>\$ 8,579,006</u>	<u>\$ 8,579,006</u>	<u>\$ -</u>	<u>\$ -</u>

Fair values of assets measured on a recurring basis at June 30, 2009 are as follows:

2009	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Investments	\$ 16,262,255	\$ 16,262,255	\$ -	\$ -
Assets of split- interest agreements	1,220,303	1,220,303	-	-
	<u>\$ 17,482,558</u>	<u>\$ 17,482,558</u>	<u>\$ -</u>	<u>\$ -</u>

Fair values for investments and assets of split-interest agreements are determined by reference to quoted market prices and other relevant information generated by market transactions.

Promises to Give – Fair Value Election

Unconditional promises to give are reported at net realizable value if at the time the promise is made payment is expected to be received in one year or less. Unconditional promises that are expected to be collected in more than one year are reported at fair value initially and in subsequent periods because the Institute elected that measure in accordance with SFAS No. 159, *The Fair Value Option of Financial Assets and Financial Liabilities*. Management believes that the use of fair value reduces the cost of measuring unconditional promises to give in periods subsequent to their receipt and provides equal or better information to users of its financial statements than if those promises were measured using present value techniques and historical discount rates.

Management considers the relationship with the donor, the donor's past history of making timely payments, and the donor's overall creditworthiness and incorporates this into a fair value measurement computation using present value techniques. The rate used in 2010 and 2009 are 1.79% and 2.56% respectively. The interest element resulting from amortization of

HOUSE EAR INSTITUTE
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010

Note 16 – Fair Value Measurements (continued)

the discount for the time value of money, computed using the effective interest rate method, is reported as contribution income.

The table below presents information about unconditional promises to give cash at June 30, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
Promises Measured at Fair Value		
Promised cash flows	\$ 1,272,500	\$ 2,261,250
Carrying amount	1,156,516	2,073,779
Fair value estimate	1,156,516	2,073,779
Measurement basis	Level 3	Level 3
Contribution income	\$ 1,113,987	\$ 3,440,935
Total changes included in the statement of activities	1,113,987	3,440,935
Promises Measured at Net Realizable Value		
Carrying amount	\$ 1,052,500	\$ 1,800,000
Total carrying amount for unconditional promises to give	2,209,016	3,873,779

The table below presents information about the changes in unconditional promises to give for the years ended June 30, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
Beginning balance	\$3,873,779	\$1,740,344
New promises received	1,042,500	3,399,537
Collections	(2,778,750)	(1,307,500)
Contribution revenue	71,487	41,398
Management and general (write-offs)	-	-
Ending balance	<u>\$2,209,016</u>	<u>\$3,873,779</u>

Note 17 – Endowment Funds

In August 2008, the Financial Accounting Standards Board issued FASB Staff Position No. FAS 117-1, “Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds” (FSP FAS 117-1). FSP FAS 117-1 provides guidance on the net asset classification of donor-restricted endowment funds for a nonprofit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). FSP FAS 117-1 also requires additional disclosures about an organization’s endowment funds (both donor-restricted endowment funds and board-designated endowment funds) whether or not the organization is subject to UPMIFA.

HOUSE EAR INSTITUTE
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010

Note 17 – Endowment Funds (continued)

The State of California enacted UPMIFA effective January 1, 2009, the provisions of which apply to endowment funds existing on or established after that date. The Institute has adopted FSP FAS 117-1 for the year ending June 30, 2009. The Board of Trustees, on the advice of legal counsel, has determined that the majority of the Institute's permanently restricted net assets meet the definition of endowment funds under UPMIFA. Based on the Institute's interpretation of UPMIFA, the Institute has reviewed all of its endowment funds and allocated funds accordingly.

The Institute's endowment consists of approximately 20 individual funds established for a variety of purposes. As required by U.S. generally accepted accounting principles, net assets associated with endowment funds are classified and reported based on the existence of donor-imposed restrictions.

The Board of Trustees of the Institute has interpreted the State Prudent Management of Institutional Funds Act (SPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Institute classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Institute in a manner consistent with the standard of prudence prescribed by SPMIFA. In accordance with SPMIFA, the Institute considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) the duration and preservation of the various funds, (2) the purposes of the donor-restricted endowment funds, (3) general economic conditions, (4) the possible effect of inflation and deflation, (5) the expected total return from income and the appreciation of investments, (6) other resources of the Institute, and (7) the Institute's investment policies.

Investment Return Objectives, Risk Parameters and Strategies: The Institute has adopted investment and spending policies, approved by the Board of Trustees, for endowment assets that attempt to provide for the long-term needs of the Institute's programs supported by its endowment funds while also maintaining the purchasing power of those endowment assets over the long-term. It is intended that the endowment assets be invested to maximize the likelihood of achieving the minimum total annual rate of return necessary to support those programs for which the endowment was funded, including a sufficient surplus to preserve the endowment's purchasing power. This minimum total rate of return objective is equivalent to the "spending target" plus inflation as measured by the Consumer Price Index. Investment risk is measured in terms of the total endowment fund; investment assets and allocation between asset classes and strategies are managed to not expose the fund to unacceptable levels of risk.

HOUSE EAR INSTITUTE
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010

Note 17 – Endowment Funds (continued)

Spending Policy: The Institute has a policy of appropriating for distribution each year 4% of its endowment fund's average fair value of the prior 12 quarters through the calendar year-end preceding the fiscal year in which the distribution is planned. In establishing this policy, the Institute considered the long-term expected return on its investment assets, the nature and duration of the individual endowment funds, many of which must be maintained in perpetuity because of donor-restrictions, and the possible effects of inflation. Actual distributions are calculated based on invested balances, not including uncollected pledges.

Endowment net asset composition by type of fund as of June 30, 2010 is as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total Net Endowment Assets</u>
Donor-restricted endowment funds	\$ (7,243,871)	\$ -	\$ 14,200,246	\$ 6,956,375

Endowment net asset composition by type of fund as of June 30, 2009 is as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total Net Endowment Assets</u>
Donor-restricted endowment funds	\$ (5,525,241)	\$ -	\$ 14,200,246	\$ 8,675,005

Changes in endowment net assets are as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total Net Endowment Assets</u>
Endowment net assets, June 30, 2008	\$ (436,112)	\$ -	\$ 14,200,068	\$ 13,763,956
Investment income, net of fees	280,562	-	-	280,562
Net depreciation of investments	(1,801,689)	-	-	(1,801,689)
Contributions	-	-	178	178
Amounts appropriated for expenditure	(3,568,002)	-	-	(3,568,002)
Endowment net assets, June 30, 2009	(5,525,241)	-	14,200,246	8,675,005
Investment income, net of fees	395,292	-	-	395,292
Net appreciation of investments	402,882	-	-	402,882
Contribution	-	-	-	-
Amounts appropriated for expenditure	(2,516,804)	-	-	(2,516,804)
Endowment net assets, June 30, 2010	\$(7,243,871)	\$ -	\$14,200,246	\$ 6,956,375

HOUSE EAR INSTITUTE
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010

Note 18 – 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; 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. John House and Derald Brackmann, 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, 2010 and 2009, the Institute received rental income from the Clinic of \$540,360 for each year. Current tenant costs owed to the Institute for the years ended June 30, 2010 and 2009 were \$96,444 and \$5,093, respectively.

One member of the Institute's Board of Trustees has acted as a broker in placing various insurance policies; commissions earned from the insurance carriers are not determinable.

Note 19 – Contingencies

As indicated in the accompanying financial statements, the Institute has shown a decrease in net assets of \$9,132,561 and \$8,088,355 for the years ended June 30, 2010, and June 30, 2009, respectively. At each of those dates, the Institute was unable to meet some of the covenants contained in the letter of credit agreement that secures its bonds payable (the Bank has provided a waiver of the liquidity requirement at June 30, 2010 and for the following fiscal year, and the net asset balance requirement for the June 30, 2010 measurement date). Those factors create an uncertainty about the Institute's ability to continue as a going concern. Management of the Institute has launched a substantial fundraising campaign and is developing a plan to restructure operations to sharply reduce expenses. The plan is aimed at creating a surplus and correcting deficiencies in their ability to meet debt requirements. The ability of the Institute to continue as a going concern is dependent on the success of the fundraising campaign, the successful implementation of the plan, and the bank's continued cooperation in waiving certain debt covenants until the Institute has recovered. The financial statements do not include any adjustments that might be necessary if the Organization is unable to continue as a going concern.

Note 20 – Subsequent Events

Subsequent events were evaluated through October 22, 2010, which is the date the financial statements were available to be issued.

ADDITIONAL INFORMATION

**HOUSE EAR INSTITUTE
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010**

HEI Project Number	Project Name	Federal Catalog Number	Agency or Pass- through Number	Contract Period	Expenditures
Department of Health and Human Services					
Pass Through National Institute of Health					
501	Human Cochlear Function	93.173	RO1 DC003552	08/01/98 - 06/30/09	\$ 387,368
524	Cell Cycle in Dev/Regeneration	93.173	RO1 DC004189	08/01/99 - 11/30/08	380,017
528	Inner Ear Sensory Organs	93.173	R55 DC004061	07/01/06 - 06/30/09	272,102
529	Measures of Otologic Pathways	93.173	R01 DC03592	07/01/08 - 06/30/09	390,751
555	Speech Pattern Recognition	93.173	RO1 DC04993	07/01/01 - 04/30/09	321,567
556	Innate Immunity in Otitis Medi	93.173	RO1 DC05025	09/01/01 - 08/31/09	378,735
597	Training Effects on Adult Coch	93.173	RO1 DC04792	05/01/01 - 06/30/09	373,840
711	Cell Cycl in Ototoxin Induced Hair Cell Death	93.173	RO1 DC007173	07/01/05 - 06/30/09	261,282
753	Frequency Place Mapping in Cochlear Implants	93.173	RO1 DC01526	04/15/02 - 03/31/09	357,543
785	Assessing Auditory Capacity in Hearing Impair Children	93.173	R01 DC006238	07/15/03 - 06/30/09	160,583
788	P30- Engineering Core B	93.173	P30 DC006276	08/01/03 - 05/31/09	249,018
799	Multisensory Processing: Plasticity&Accomodation	93.173	R01 DC008308	07/01/06 - 06/30/09	438,504
804	Development & Evaluation of a Concatenative Cued	93.173	R03 DC007976	07/05/06 - 06/30/10	18,086
810	Cell&Molecular Analysis of Human Temporal Bones	93.173	U24 DC008625	09/21/06 - 08/31/08	455,251
814	Role of BMP4 in Otic Placode Induction	93.173	R03 DC008692	01/01/07 - 12/31/09	58,752
816	Visual Speech Perception & Neural Processing	93.173	R55 008583-01	02/01/07 - 01/31/09	294,581
820	9th. Research Conf on Recent Advances Otitis	93.173	R13 DC008950	06/07/07 - 06/08/09	17,126
826	Sudden Hearing Loss multicenter Trail	93.173	U01 DC006296	06/01/07 - 05/31/08	(153)
832	Role of Spiral Ligament Fibrocytes in Inner Ear	93.173	R03 DC008696	03/01/08 - 02/28/11	212,298
838	Dev & Adaptive Behavior of Young Children	93.173	R01 DC009561	09/01/08 - 08/31/09	600,716
842	DNA Repair Mechanisms Underlying Hair Cell	93.173	F32DC010125	03/01/09 - 02/28/10	55,637
847	2009 Conference on Implantable Auditory Prostheses	93.173	1R13DC010300-01	07/01/09 - 06/30/10	30,000
848	Structural Basis of OUter Hair Cell Function	93.173	5R01DC010146-02	07/01/09 - 06/30/10	386,538
860	Regulation of Inflammatory Respiratory	93.173	1 R01 DC010397-01	12/01/09 - 11/30/10	115,146
864	2010 Conf on Neurofibromatosis Type 2	93.173	1R13DC010973-01	04/01/10 - 03/31/10	15,000
Pass-through from Compreval Inc.- Binaural Assessment					
791	Instrument for Cochlear Implant	93.173	R44 DC005759	09/01/07 - 08/31/09	50,183
Pass-through from Compreval Inc.- Use of Speech					
839	Recognition Technology	93.173	R43 DC008212	09/01/08 - 11/30/09	4,281
862	Pass-through from Compreval Inc. - Pediatric Virtual Audio	93.173	1R43DC010510-01	01/01/10 - 12/31/10	14,648
Pass-through from John Hopkins University - Childhood					
754	Development after Cochlear Implant	93.173	8206 00394	05/01/02 - 06/30/09	150,035
845	Pass-through from O-Ray - Pharmacokinetics of Fluticisone	93.173	R43 DC008477	03/23/09 - 02/01/10	12,306
Pass-through from Purdue University - Purdue Multimodal					
824	Tests of Spoken Word Recognition	93.173	R01 DC008875	03/09/07 - 01/31/12	109,442
Pass-through from University of Iowa - Sub-Multimodal					
871	Test of Spoken Work	93.173	1000759637	07/17/09 - 01/31/11	32,053
Total		93.173			6,603,236
ARRA - Pass-through from University of Cincinnati -					
501	ARRA - Human Cochlear Function	93.701	2R01DC003552-09A1	07/17/09 - 06/30/11	104,111
524	ARRA - Cell Cycle in Dev/Regeneration	93.701	3R01DC004189-08S1	08/14/09 - 07/31/11	173,341
529	ARRA - Speech Pattern Recognition	93.701	3R01DC003592-05A2S1	07/17/09 - 06/30/11	55,726
555	ARRA - Speech Pattern Recognition	93.701	3R01DC004993-08S1	07/17/09 - 06/30/10	191,566
556	ARRA - Innate Immunity in Otitis Medi	93.701	3R01DC005025-06S1	07/17/09 - 06/30/11	58,934
597	ARRA - Training Effects on Adult Coch	93.701	5R01DC004792-07S1	07/17/09 - 06/30/11	91,830
788	ARRA - P30- Engineering Core B	93.701	3P30DC006276-06S1	07/17/09 - 06/30/11	16,033
810	ARRA - Cell&Molecular Analysis of Human Temporal Bon	93.701	3U24DC008625-03S2	07/17/09 - 06/30/11	121,870
832	ARRA - Role of Spiral Ligament Fibrocytes in Inner Ear	93.701	3R03DC008696-02S2	09/03/09 - 02/28/11	51,135
838	ARRA - Dev & Adaptive Behavior of Young Children	93.701	3R01DC009561-01S1	07/17/09 - 06/30/10	40,927
846	ARRA - Using Current-Focusing and Current-Steerin	93.701	1R03DC010064-01	06/02/09 - 05/31/10	161,685
851	ARRA - Genetic Analysis of Age Related	93.701	1 R01 DC010215-01	09/03/09 - 07/31/10	587,657
853	ARRA - Jr. faculty Recruitment into New Auditory	93.701	1P30DC010743-01	09/17/09 - 08/31/10	487,358
ARRA - Pass-through from University of Cincinnati -					
869	Temporal Processing	93.701	1R15DC0110004-01	04/08/10 - 03/31/11	5,284
Total ARRA		93.701			2,147,457

**HOUSE EAR INSTITUTE
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010
(Continued)**

HEI Project Number	Project Name	Federal Catalog Number	Agency or Pass- through Number	Contract Period	Expenditures
Department of Defense					
861	Mouse Model of Schwannomatosis	12.420	W81XWH-10-1-0070	01/15/10 - 01/14/11	\$ 42,840
	Pass-through from UC San Francisco - Preclinical Mouse				
834	Models of Neurofibromatosis	12.420	W81 XWH-05-1-0265	01/01/08 - 09/30/09	31,109
	Pass-through from Cincinnati Children's Hospital -				
850	Therapeutic Targets for Peripheral Nerve	12.420	CHMC105457M1	03/01/09 - 02/28/10	<u>36,548</u>
	Total	12.420			<u>110,497</u>
Total Federal Grants					<u><u>\$ 8,861,190</u></u>

**HOUSE EAR INSTITUTE
NOTES TO THE SCHEDULE OF FEDERAL FINANCIAL ASSISTANCE
FOR THE YEAR ENDED JUNE 30, 2010**

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 2010. 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.

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	\$ 8,861,190
Other Grants	
Baylor University	55,211
Children's Tumor Foundation	308,405
Cochlear Corporation	103,487
Edison Pharmaceuticals	20,085
Gallaudet University	15,000
Bundy Foundation	80,752
Labotarios Salvat	38,955
Compreval	16,470
National Science Foundation	26,568
Miscellaneous consulting	50,006
	<hr/>
Total Grants and Contracts Revenue per Audited Financial Statements	<u><u>\$ 9,576,131</u></u>

SINGLE AUDIT



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

To the Board of Trustees
House Ear Institute

We have audited the financial statements of House Ear Institute as of and for the year ended June 30, 2010, and have issued our report thereon dated October 22, 2010. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Organization's internal control over financial reporting as a basis for designing our audit procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Organization's internal control over financial reporting. Accordingly we do not express an opinion on the effectiveness of the Organization's internal control over financial reporting.

A deficiency in internal control 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 and correct misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Organization's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, 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 or other matters that are required to be reported under *Government Auditing Standards*.

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

October 22, 2010



**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH REQUIREMENTS
THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR
PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN
ACCORDANCE WITH OMB CIRCULAR A-133**

To the Board of Trustees
House Ear Institute

Compliance

We have audited House Ear Institute's compliance with the types of compliance requirements described in *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on of the Organization's major federal programs in the year ended June 30, 2010. The Organization's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Organization's management. Our responsibility is to express an opinion on the Organization'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 the Organization's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Organization's compliance with those requirements.

In our opinion, the House Ear Institute complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2010.

Internal Control Over Compliance

Management of the Organization 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 the Organization's internal control over compliance with requirements that could have a direct and material effect on a major federal program to determine the 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, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Organization's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we considered to be material weaknesses, as defined above.

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

Wensick & Caron

October 22, 2010

**HOUSE EAR INSTITUTE
STATUS OF FINDINGS AND QUESTIONED COSTS
JUNE 30, 2010**

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 significant deficiencies relating to the audit of the financial statements are reported in the Independent Auditors Report on Internal Control over Financial Reporting and on Compliance and Other Matters based on an Audit of Financial Statements Performed in Accordance with *Governmental Auditing Standards* were reported during the audit of the financial statements.
3. No instances of noncompliance material to the financial statements of the Organization, which would be required to be reported in accordance with *Government Auditing Standards* were disclosed during the audit.
4. No significant deficiencies relating to the audit of the major federal award program were reported in the Independent Auditors Report on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133.
5. The auditor’s report on compliance for the major federal award programs for House Ear Institute expresses an unqualified opinion on all major federal programs.
6. There are no audit findings relating to the major program that the auditor is required to report under section 510(a) of OMB Circular A-133.
7. The programs tested as major programs included:

Name of Program	CFDA Number
Trans-NIH Recovery Act Research Support	93.701
Military Medical Research and Development	12.420

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

B. FINDINGS – FINANCIAL STATEMENTS AUDIT

None

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

None

**HOUSE EAR INSTITUTE
SCHEDULE OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS
JUNE 30, 2010**

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

None