

*Financial Statements*

**HOUSE RESEARCH INSTITUTE**

June 30, 2011



# HENSIEK & CARON

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## INDEPENDENT AUDITOR'S REPORT

To The Board of Trustees  
House Research Institute

We have audited the accompanying statement of financial position of House Research Institute (formerly House Ear Institute), a nonprofit corporation, as of June 30, 2011, and the related statement of activities and 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 prior year summarized comparative information has been derived from House Ear Institute's 2010 financial statements and, in our report dated October 22, 2010 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 Research Institute, as of June 30, 2011, 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 our report dated October 7, 2011, on our consideration of House Research 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. The 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 basic 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 basic financial statements as a whole.

*Wensick & Caron*

October 7, 2011

**HOUSE RESEARCH INSTITUTE  
STATEMENTS OF FINANCIAL POSITION  
JUNE 30, 2011 AND 2010**

**ASSETS**

|   | <b>2011</b>          | <b>2010</b>          |
|---|----------------------|----------------------|
| <b>Assets</b>                           |                      |                      |
| Cash                                    | \$ 1,633,376         | \$ 655,095           |
| Bequests and other donations receivable | 1,164,722            | 2,031,932            |
| Accounts receivable, net                | 2,023,720            | 1,996,197            |
| Educational and research supplies       | 32,121               | 33,736               |
| Prepaid expenses and other assets       | 23,327               | 9,050                |
| Pledges receivable                      | 8,448,762            | 2,209,016            |
| Notes receivable                        | 656,039              | 303,651              |
| Investments                             | 5,399,960            | 7,350,635            |
| Assets of split-interest agreements     | 1,346,261            | 1,228,371            |
| Patent development costs                | 38,229               | 38,229               |
| Patent costs, net                       | 79,762               | 92,743               |
| Deferred bond costs, net                | 885,286              | 919,118              |
| Facilities and equipment, at cost, net  | 40,429,841           | 43,100,073           |
| <b>Total Assets</b>                     | <b>\$ 62,161,406</b> | <b>\$ 59,967,846</b> |

**LIABILITIES AND NET ASSETS**

|  |                      |                      |
|--|----------------------|----------------------|
| <b>Liabilities</b>   |                      |                      |
| Accounts payable and accrued expenses                      | \$ 1,804,248         | \$ 1,504,516         |
| Accrued interest payable                                   | 73,299               | 72,471               |
| Deferred revenue   | 194,997              | 379,181              |
| Liability to beneficiaries under split-interest agreements | 602,287              | 610,508              |
| Deferred revenue - pooled income fund                      | 35,121               | 36,823               |
| Bonds payable  | 29,910,000           | 29,910,000           |
| <b>Total Liabilities</b>                                   | 32,619,952           | 32,513,499           |
| <b>Net Assets</b>  |                      |                      |
| Unrestricted   | 2,067,418            | 6,645,207            |
| Temporarily restricted                                     | 11,548,789           | 6,608,893            |
| Permanently restricted                                     | 15,925,247           | 14,200,247           |
| <b>Total Net Assets</b>                                    | 29,541,454           | 27,454,347           |
| <b>Total Liabilities and Net Assets</b>                    | <b>\$ 62,161,406</b> | <b>\$ 59,967,846</b> |

**HOUSE RESEARCH INSTITUTE**  
**STATEMENT OF ACTIVITIES**  
**FOR THE YEAR ENDED JUNE 30, 2011**  
WITH SUMMARIZED INFORMATION FOR THE YEAR ENDED JUNE 30, 2010

|   | 2011                  |                           |                           | 2010                |                       |
|---|-----------------------|---------------------------|---------------------------|---------------------|-----------------------|
|   | Unrestricted          | Temporarily<br>Restricted | Permanently<br>Restricted | Total               | Total                 |
| <b>Public Support and Revenue</b>                         |                       |                           |                           |                     |                       |
| Contributions   | \$ 4,982,579          | \$ 8,051,947              | \$ 1,725,000              | \$ 14,759,526       | \$ 3,519,872          |
| Grants and contracts - direct                             | 5,986,665             | -                         | -                         | 5,986,665           | 6,045,980             |
| Grants and contracts - indirect                           | 3,854,544             | -                         | -                         | 3,854,544           | 3,530,151             |
| Special events  | -                     | -                         | -                         | -                   | 297,500               |
| Educational courses                                       | 113,790               | -                         | -                         | 113,790             | 108,630               |
| Investment returns, net                                   | 113,152               | -                         | -                         | 113,152             | 798,175               |
| Building operations                                       | 609,560               | -                         | -                         | 609,560             | 627,452               |
| Clinical services   | 1,340,337             | -                         | -                         | 1,340,337           | 1,246,504             |
| Royalties   | 115,471               | -                         | -                         | 115,471             | 378,052               |
| Other   | 274,579               | -                         | -                         | 274,579             | 399,453               |
| Change in value of split-interest<br>agreements           | -                     | 127,813                   | -                         | 127,813             | 246,036               |
| Net assets released from restrictions                     | 3,239,864             | (3,239,864)               | -                         | -                   | -                     |
| <b>Total Public Support<br/>and Revenue</b>               | <u>20,630,541</u>     | <u>4,939,896</u>          | <u>1,725,000</u>          | <u>27,295,437</u>   | <u>17,197,805</u>     |
| <b>Expenses</b>   |                       |                           |                           |                     |                       |
| <b>Program Services</b>                                   |                       |                           |                           |                     |                       |
| Research  | 16,142,869            | -                         | -                         | 16,142,869          | 16,899,207            |
| Education   | 1,108,631             | -                         | -                         | 1,108,631           | 686,289               |
| <b>Total Program Services</b>                             | <u>17,251,500</u>     | <u>-</u>                  | <u>-</u>                  | <u>17,251,500</u>   | <u>17,585,496</u>     |
| <b>Supporting Services</b>                                |                       |                           |                           |                     |                       |
| Management and general                                    | 5,457,659             | -                         | -                         | 5,457,659           | 6,135,247             |
| Fund raising  | 1,366,273             | -                         | -                         | 1,366,273           | 1,155,946             |
| <b>Total Supporting Services</b>                          | <u>6,823,932</u>      | <u>-</u>                  | <u>-</u>                  | <u>6,823,932</u>    | <u>7,291,193</u>      |
| <b>Total Expenses Before<br/>Debt Service Costs</b>       | <u>24,075,432</u>     | <u>-</u>                  | <u>-</u>                  | <u>24,075,432</u>   | <u>24,876,689</u>     |
| <b>Change in Net Assets Before<br/>Debt Service Costs</b> | (3,444,891)           | 4,939,896                 | 1,725,000                 | 3,220,005           | (7,678,884)           |
| <b>Debt Service Costs</b>                                 | <u>1,132,898</u>      | <u>-</u>                  | <u>-</u>                  | <u>1,132,898</u>    | <u>1,453,677</u>      |
| <b>Change in Net Assets</b>                               | <u>\$ (4,577,789)</u> | <u>\$ 4,939,896</u>       | <u>\$ 1,725,000</u>       | <u>\$ 2,087,107</u> | <u>\$ (9,132,561)</u> |

**HOUSE RESEARCH INSTITUTE  
STATEMENTS OF CHANGES IN NET ASSETS  
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**

|                                  | <u>Unrestricted</u> | <u>Temporarily<br/>Restricted</u> | <u>Permanently<br/>Restricted</u> | <u>Total</u>         |
|----------------------------------|---------------------|-----------------------------------|-----------------------------------|----------------------|
| <b>Net Assets, June 30, 2009</b> | \$ 15,816,987       | \$ 6,569,674                      | \$14,200,247                      | \$ 36,586,908        |
| <b>Change in Net Assets</b>      | <u>(9,171,780)</u>  | <u>39,219</u>                     | <u>-</u>                          | <u>(9,132,561)</u>   |
| <b>Net Assets, June 30, 2010</b> | 6,645,207           | 6,608,893                         | 14,200,247                        | 27,454,347           |
| <b>Change in Net Assets</b>      | <u>(4,577,789)</u>  | <u>4,939,896</u>                  | <u>1,725,000</u>                  | <u>2,087,107</u>     |
| <b>Net Assets, June 30, 2011</b> | <u>\$ 2,067,418</u> | <u>\$ 11,548,789</u>              | <u>\$ 15,925,247</u>              | <u>\$ 29,541,454</u> |

**HOUSE RESEARCH INSTITUTE  
STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**

|   | <u>2011</u>         | <u>2010</u>        |
|---|---------------------|--------------------|
| <b>Cash Flows from Operating Activities</b>                     |                     |                    |
| Cash received from service recipients                           | \$ 11,424,702       | \$ 11,266,154      |
| Cash received from donors                                       | 9,361,990           | 5,639,353          |
| Cash received from building operations, net                     | 658,537             | 571,465            |
| Cash paid to suppliers and employees                            | (20,615,135)        | (21,842,572)       |
| Interest and dividends received                                 | 21,581              | 153,885            |
| Interest and other debt service costs paid                      | <u>(1,132,070)</u>  | <u>(1,507,376)</u> |
| <b>Net Cash Used in Operating Activities</b>                    | <u>(280,395)</u>    | <u>(5,719,091)</u> |
| <b>Cash Flows from Investing Activities</b>                     |                     |                    |
| Additions to facilities and equipment                           | (468,278)           | (217,544)          |
| Purchases of investments  | (126,730)           | (5,873,954)        |
| Proceeds from sale of investments                               | 2,181,072           | 15,461,818         |
| Loans made  | (400,000)           | -                  |
| Collections on notes  | <u>47,612</u>       | <u>47,136</u>      |
| <b>Net Cash Provided by Investing Activities</b>                | <u>1,233,676</u>    | <u>9,417,456</u>   |
| <b>Cash Flows from Financing Activities</b>                     |                     |                    |
| Proceeds from donations and investment earnings restricted for: |                     |                    |
| Endowment   | 25,000              | -                  |
| Payments on notes payable and line of credit                    | <u>-</u>            | <u>(3,700,000)</u> |
| <b>Net Cash (Used in) Provided by Financing Activities</b>      | <u>25,000</u>       | <u>(3,700,000)</u> |
| <b>Net Decrease in Cash</b>                                     | 978,281             | (1,635)            |
| <b>Cash, Beginning</b>  | <u>655,095</u>      | <u>656,730</u>     |
| <b>Cash, Ending</b>   | <u>\$ 1,633,376</u> | <u>\$ 655,095</u>  |

**HOUSE RESEARCH INSTITUTE**  
**STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**  
(Continued)

|   | <u>2011</u>             | <u>2010</u>               |
|---|-------------------------|---------------------------|
| <b>Reconciliation of the Change in Net Assets</b>   |                         |                           |
| <b>To Net Cash Used in Operating Activities</b>   |                         |                           |
| Change in Net Assets  | \$ 2,087,107            | \$ (9,132,561)            |
| Adjustments to reconcile the change in net assets<br>to net cash used in operating activities |                         |                           |
| Change in allowance for uncollectible accounts  | (80,983)                | 128,027                   |
| Change in present value of pledges receivable   | 131,754                 | (71,487)                  |
| Depreciation and amortization   | 3,185,323               | 3,297,133                 |
| Net realized and unrealized losses on investments   | (103,667)               | (676,246)                 |
| Change in value of split-interest agreements  | (127,813)               | (246,036)                 |
| Loss on disposition of property and equipment   | -                       | 472,497                   |
| (Increase) Decrease in:   |                         |                           |
| Donations receivable  | 867,210                 | 157,218                   |
| Accounts receivable   | 53,460                  | (697,730)                 |
| Educational and research supplies   | 1,615                   | 20,820                    |
| Pledges receivable  | (6,371,500)             | 1,736,250                 |
| Prepaid expenses and other assets   | (14,277)                | 3,755                     |
| Deferred bond costs   | -                       | (318,063)                 |
| Increase (Decrease) in:   |                         |                           |
| Accounts payable and accrued expenses   | 299,732                 | (410,069)                 |
| Accrued bond interest payable   | 828                     | (53,699)                  |
| Other deferred revenue  | (184,184)               | 71,100                    |
| Donations restricted for long-term purposes:  |                         |                           |
| Cash donations  | <u>(25,000)</u>         | <u>-</u>                  |
| <br><b>Net Cash Used in Operating Activities</b>  | <br><u>\$ (280,395)</u> | <br><u>\$ (5,719,091)</u> |

**HOUSE RESEARCH INSTITUTE  
STATEMENT OF FUNCTIONAL EXPENSES  
FOR THE YEAR ENDED JUNE 30, 2011  
WITH SUMMARIZED INFORMATION FOR JUNE 30, 2010**

|   | 2011                 |                     |                      |                        |                     |                      | 2010                 |
|---|----------------------|---------------------|----------------------|------------------------|---------------------|----------------------|----------------------|
|   | Program Services     |                     |                      | Supporting Services    |                     |                      | Total Expenses       |
|   | Research             | Education           | Total                | Management and General | Fund Raising        | Total                |                      |
| Salaries and wages                              | \$ 7,880,477         | \$ 301,706          | \$ 8,182,183         | \$ 2,369,914           | \$ 623,045          | \$ 2,992,959         | \$ 11,175,142        |
| Taxes and employee benefits                     | 1,698,536            | 61,490              | 1,760,026            | 324,131                | 126,654             | 450,785              | 2,210,811            |
| <b>Total Personnel Costs</b>                    | 9,579,013            | 363,196             | 9,942,209            | 2,694,045              | 749,699             | 3,443,744            | 13,385,953           |
| Professional fees and contract service payments | 1,219,779            | 391,410             | 1,611,189            | 617,762                | 202,083             | 819,845              | 2,431,034            |
| Occupancy and related expenses                  | 1,050,075            | 35,076              | 1,085,151            | 517,564                | 31,627              | 549,191              | 1,634,342            |
| Travel, conferences, conventions and meetings   | 179,388              | 80,728              | 260,116              | 110,695                | 32,242              | 142,937              | 403,053              |
| Special supplies and services                   | 904,556              | 66,295              | 970,851              | 52,828                 | 21,298              | 74,126               | 1,044,977            |
| Cost of goods sold                              | 427,730              | 1,395               | 429,125              | -                      | -                   | -                    | 429,125              |
| Minor equipment and equipment maintenance       | 309,585              | -                   | 309,585              | 189,074                | -                   | 189,074              | 498,659              |
| Office supplies and services                    | 160,901              | 100,615             | 261,516              | 621,340                | 226,923             | 848,263              | 1,109,779            |
| <b>Total Expenses Before Depreciation</b>       | 13,831,027           | 1,038,715           | 14,869,742           | 4,803,308              | 1,263,872           | 6,067,180            | 20,936,922           |
| Depreciation - building                         | 1,610,786            | 60,348              | 1,671,134            | 535,189                | 62,390              | 597,579              | 2,268,713            |
| Depreciation - equipment and furniture          | 701,056              | 9,568               | 710,624              | 119,162                | 40,011              | 159,173              | 869,797              |
| <b>Total Depreciation</b>                       | 2,311,842            | 69,916              | 2,381,758            | 654,351                | 102,401             | 756,752              | 3,138,510            |
| <b>Total Expenses Before Debt Service Costs</b> | <u>\$ 16,142,869</u> | <u>\$ 1,108,631</u> | <u>\$ 17,251,500</u> | <u>\$ 5,457,659</u>    | <u>\$ 1,366,273</u> | <u>\$ 6,823,932</u>  | <u>\$ 24,075,432</u> |
|   |                      |                     |                      |                        |                     | <u>\$ 24,876,689</u> |                      |

**HOUSE RESEARCH INSTITUTE**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

**Note 1 - Summary of Significant Accounting Policies**

**Organization**

House Research Institute (formerly 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 RESEARCH INSTITUTE  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2011**

**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. Contract revenue received from private companies is reported as deferred revenue until the contracted services are provided. Deposits on leases of the building are also classified as deferred revenue.

**HOUSE RESEARCH INSTITUTE  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2011**

**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.

**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, 2010.

**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.

The accounting standard on accounting for uncertainty in income taxes provides guidance on how uncertain tax positions should be recognized, measured, presented and disclosed in the financial statements. Examples of tax positions include the tax-exempt status of the Organization and various positions related to the potential sources of unrelated business taxable income (UBIT). The Institute believes that it has no uncertain tax positions that impact its 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.

**Reclassifications**

Certain accounts in the prior-year financial statements have been reclassified for comparative purposes to conform with the presentation in the current-year financial statements.

**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 \$250,000 per institution. At June 30, 2011, the Institute's uninsured cash balance totaled \$1,503,725.

**HOUSE RESEARCH INSTITUTE**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

**Note 3 – Accounts Receivable**

Accounts receivable consists of the following:

|                                      | <u>2011</u>         | <u>2010</u>         |
|--------------------------------------|---------------------|---------------------|
| Accounts receivable                  | \$ 2,530,354        | \$ 2,583,814        |
| Less allowance for doubtful accounts | 506,634             | 587,617             |
|                                      | <u>\$ 2,023,720</u> | <u>\$ 1,996,197</u> |

**Note 4 – Patent Costs**

Patent costs consist of the following:

|                               | <u>2011</u>      | <u>2010</u>       |
|-------------------------------|------------------|-------------------|
| Patents costs                 | \$ 220,688       | \$ 220,688        |
| Less accumulated amortization | 140,926          | 127,945           |
|                               | <u>\$ 79,762</u> | <u>\$ 105,725</u> |

**Note 5 – Deferred Bond Costs**

Deferred bond costs consist of the following:

|                               | <u>2011</u>       | <u>2010</u>       |
|-------------------------------|-------------------|-------------------|
| Deferred bond costs           | \$ 1,014,977      | \$ 1,014,977      |
| Less accumulated amortization | 129,691           | 95,859            |
|                               | <u>\$ 885,286</u> | <u>\$ 919,118</u> |

**Note 6 – Pledges Receivable**

Unconditional promises to give consist of the following:

|                                      | <u>2011</u>         | <u>2010</u>         |
|--------------------------------------|---------------------|---------------------|
| Receivable in less than one year     | \$ 2,404,000        | \$ 1,052,500        |
| Receivable in one to five years      | 6,142,500           | 965,000             |
| Receivable in more than five years   | 150,000             | 307,500             |
| Total unconditional promises to give | 8,696,500           | 2,325,000           |
| Less discounts to net present value  | 247,738             | 115,984             |
| Net unconditional promises to give   | <u>\$ 8,448,762</u> | <u>\$ 2,209,016</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 2011 and 2010 was 1.75% and 1.79%, respectively. Management believes all pledges are collectible.

**HOUSE RESEARCH INSTITUTE**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

**Note 6 – Pledges Receivable (continued)**

|   | <u>2011</u>         | <u>2010</u>         |
|---|---------------------|---------------------|
| Restricted for:                                       |                     |                     |
| Building construction, maintenance and debt reduction | \$ 78,157           | \$ 125,175          |
| Specific research projects                            | 5,719,723           | 1,760,152           |
| Permanently restricted                                | 1,656,423           | -                   |
| Unrestricted  | 994,459             | 323,689             |
|   | <u>\$ 8,448,762</u> | <u>\$ 2,209,016</u> |

**Note 7 – Investments**

As of June 30, 2011 and 2010, investments consist of the following:

| <u>2011</u>                            | <u>Aggregate<br/>Fair Value</u> | <u>Cost</u>         |
|--|---------------------------------|---------------------|
| Cash and cash equivalents              | \$ 97,507                       | \$ 97,507           |
| Corporate stocks                       | 6,537                           | 6,537               |
| United States Treasury bonds and notes | 5,295,916                       | 5,213,133           |
|  | <u>\$ 5,399,960</u>             | <u>\$ 5,316,891</u> |
|  |                                 |                     |
| <u>2010</u>                            | <u>Aggregate<br/>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> |

Investment returns are summarized as follows:

| <u>2011</u>                        | <u>Unrestricted</u> | <u>Temporarily<br/>Restricted</u> | <u>Total</u>      |
|------------------------------------|---------------------|-----------------------------------|-------------------|
| Interest and dividends             | \$ 21,581           | \$ -                              | \$ 21,581         |
| Net realized and unrealized losses | 103,667             | -                                 | 103,667           |
| Investment fees                    | (12,096)            | -                                 | (12,096)          |
|                                    | <u>\$ 113,152</u>   | <u>\$ -</u>                       | <u>\$ 113,152</u> |
|                                    |                     |                                   |                   |
| <u>2010</u>                        | <u>Unrestricted</u> | <u>Temporarily<br/>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> |

**HOUSE RESEARCH INSTITUTE  
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**Note 8 – 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 9 – Facilities and Equipment**

Facilities and equipment consist of the following:

|                               | <b>2011</b>   | <b>2010</b>   |
|-------------------------------|---------------|---------------|
| Building                      | \$ 67,315,703 | \$ 67,315,703 |
| Furniture and equipment       | 14,208,567    | 13,740,291    |
|                               | 81,524,270    | 81,055,994    |
| Less accumulated depreciation | (41,094,429)  | (37,955,921)  |
|                               | \$ 40,429,841 | \$ 43,100,073 |

**Note 10 – 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 RESEARCH INSTITUTE**  
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**Note 10 – 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, 2011 and 2010, the Institute did not meet the minimum levels of liquidity or the adjusted net asset requirement. The Bank has provided waivers of the liquidity requirement at June 30, 2011 and 2010, and the net asset balance requirement for the June 30, 2011 and 2010 measurement dates.

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, 2011 and 2010 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, 2011 or 2010. 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, 2011 and 2010 was \$874,216 and \$1,303,624, respectively. The interest rate in effect on outstanding bonds at June 30, 2011 and 2010 was .10% and .26%, 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.

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NOTES TO FINANCIAL STATEMENTS  
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**Note 11 – Net Assets**

Restricted net assets consist of the following:

|                                   | <b>2011</b>  | <b>2010</b>  |
|-----------------------------------|--------------|--------------|
| Temporarily Restricted Net Assets |              |              |
| Research Programs                 | \$ 9,854,862 | \$ 4,696,678 |
| Educational Programs              | 696,925      | 1,043,025    |
| Future Operations                 | 997,002      | 869,190      |
|                                   | \$11,548,789 | \$ 6,608,893 |
| Permanently Restricted Net Assets |              |              |
| Operations                        | \$ 5,873,837 | \$ 5,648,837 |
| Research Programs                 | 6,461,977    | 4,961,977    |
| Building Operations               | 2,312,872    | 2,312,872    |
| Educational Programs              | 1,276,561    | 1,276,561    |
|                                   | \$15,925,247 | \$14,200,247 |

**Note 12 – 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. As of July 1, 2009 the Institute suspended matching contributions.

**Note 13 – 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 2011 to 2015. The lease with the House Ear Clinic contains options to renew after the first year at the discretion of the Clinic. Future minimum lease payments for the next four years are as follows:

| <u>Years ending June 30,</u> |    |         |
|------------------------------|----|---------|
| 2012                         | \$ | 533,966 |
| 2013                         |    | 67,983  |
| 2014                         |    | 67,983  |
| 2015                         |    | 67,983  |

**HOUSE RESEARCH INSTITUTE  
NOTES TO FINANCIAL STATEMENTS  
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**Note 14 – Fair Value Measurements**

Fair Values Measured on Recurring Basis

Fair values of assets measured on a recurring basis at June 30, 2011 are as follows:

| <b>2011</b>                                | <b>Fair Value</b>   | <b>Quoted Prices in<br/>Active Markets<br/>for Identical<br/>Assets (Level 1)</b> | <b>Significant Other<br/>Observable<br/>Inputs (Level 2)</b> | <b>Significant Other<br/>Unobservable<br/>Inputs (Level 3)</b> |
|--|---------------------|---|--|--|
| Investments                                | \$ 5,399,960        | \$ 5,399,960  | \$ -   | \$ -   |
| Assets of split-<br>interest<br>agreements | 1,346,261           | 1,346,261   | -  | -  |
|  | <u>\$ 6,746,221</u> | <u>\$ 6,746,221</u>   | <u>\$ -</u>  | <u>\$ -</u>  |

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

| <b>2010</b>                                | <b>Fair Value</b>   | <b>Quoted Prices in<br/>Active Markets<br/>for Identical<br/>Assets (Level 1)</b> | <b>Significant Other<br/>Observable<br/>Inputs (Level 2)</b> | <b>Significant Other<br/>Unobservable<br/>Inputs (Level 3)</b> |
|--|---------------------|---|--|--|
| Investments                                | \$ 7,350,635        | \$ 7,350,635  | \$ -   | \$ -   |
| Assets of split-<br>interest<br>agreements | 1,228,371           | 1,228,371   | -  | -  |
|  | <u>\$ 8,579,006</u> | <u>\$ 8,579,006</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 2011 and 2010 are 1.75% and 1.75% respectively. The interest element resulting from amortization of

**HOUSE RESEARCH INSTITUTE**  
**NOTES TO FINANCIAL STATEMENTS**  
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**Note 14 – 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, 2011 and 2010:

|  | <u>2011</u>  | <u>2010</u>  |
|--|--------------|--------------|
| Promises Measured at Fair Value                          |              |              |
| Promised cash flows                                      | \$ 6,292,500 | \$ 1,272,500 |
| Carrying amount  | 6,044,762    | 1,156,516    |
| Fair value estimate                                      | 6,044,762    | 1,156,516    |
| Measurement basis  | Level 3      | Level 3      |
| Contribution income                                      | \$ 9,268,246 | \$ 1,113,987 |
| Total changes included in the statement of activities    | 9,268,246    | 1,113,987    |
|  |              |              |
| Promises Measured at Net Realizable Value                |              |              |
| Carrying amount  | \$ 2,404,000 | \$ 1,052,500 |
| Total carrying amount for unconditional promises to give | 8,448,762    | 2,209,016    |

The table below presents information about the changes in unconditional promises to give for the years ended June 30, 2011 and 2010:

|                                     | <u>2011</u>         | <u>2010</u>         |
|-------------------------------------|---------------------|---------------------|
| Beginning balance                   | \$ 2,209,016        | \$ 3,873,779        |
| New promises received               | 9,400,000           | 1,042,500           |
| Collections                         | (3,028,500)         | (2,778,750)         |
| Contribution revenue                | (131,754)           | 71,487              |
| Management and general (write-offs) | -                   | -                   |
| Ending balance                      | <u>\$ 8,448,762</u> | <u>\$ 2,209,016</u> |

**Note 15 – 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 RESEARCH INSTITUTE**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

**Note 15 – 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 RESEARCH INSTITUTE**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

**Note 15 – 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, 2011 is as follows:

|                                  | <u>Unrestricted</u> | <u>Temporarily Restricted</u> | <u>Permanently Restricted</u> | <u>Total Net Endowment Assets</u> |
|----------------------------------|---------------------|-------------------------------|-------------------------------|-----------------------------------|
| Donor-restricted endowment funds | \$ (7,534,809)      | \$ -                          | \$ 15,925,247                 | \$ 8,390,438                      |

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                      |

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, 2009  | \$(5,525,241)       | \$ -                          | \$ 14,200,247                 | \$ 8,675,006                      |
| Investment income, net of fees       | 395,292             | -                             | -                             | 395,292                           |
| Net appreciation of investments      | 402,882             | -                             | -                             | 402,882                           |
| Contributions                        | -                   | -                             | -                             | -                                 |
| Amounts appropriated for expenditure | (2,516,804)         | -                             | -                             | (2,516,804)                       |
| Endowment net assets, June 30, 2010  | (7,243,871)         | -                             | 14,200,247                    | 6,956,376                         |
| Investment income, net of fees       | 173,855             | -                             | -                             | 173,855                           |
| Net depreciation of investments      | (60,703)            | -                             | -                             | (60,703)                          |
| Contribution                         | -                   | -                             | 1,725,000                     | 1,725,000                         |
| Amounts appropriated for expenditure | (404,090)           | -                             | -                             | (404,090)                         |
| Endowment net assets, June 30, 2011  | \$(7,534,809)       | \$ -                          | \$15,925,247                  | \$ 8,390,438                      |

**HOUSE RESEARCH INSTITUTE  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2011**

**Note 16 – 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, Derald Brackmann and William Luxford 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, 2011 and 2010, the Institute received rental income from the Clinic of \$465,984 and \$540,360, respectively. Current tenant costs owed to the Institute for the years ended June 30, 2011 and 2010 were \$8,168 and \$96,444, 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 17 – Contingencies**

The Institute has shown significant decreases in net assets for five out of the last six years. As a result of these losses, the Institute has been 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 and net asset balance requirements for June 30, 2010 and 2011). The ability of the Institute to continue as a going concern is dependent on the bank's continued cooperation in waiving certain debt covenants until the Institute has recovered. Recovery will depend on the success of current fundraising efforts and the successful implementation of plans to reduce expenses in order to produce increases in net assets. The financial statements do not include any adjustments that might be necessary if the Institute is unable to continue as a going concern.

**Note 18 – Subsequent Events**

Subsequent events were evaluated through October 7, 2011, which is the date the financial statements were available to be issued. There were no subsequent events that would require adjustments or disclosures in these financial statements.

**ADDITIONAL INFORMATION**

**HOUSE RESEARCH INSTITUTE  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2011**

| HEI<br>Project<br>Number                                     | Project Name   | Federal<br>Catalog<br>Number | Agency or Pass-<br>through Number | Contract Period     | Expenditures     |
|--|--|------------------------------|-----------------------------------|---------------------|------------------|
| <b>Department of Health and Human Services</b>               |  |                              |                                   |                     |                  |
| <b>Pass Through National Institute of Health</b>             |  |                              |                                   |                     |                  |
| 501  | Human Cochlear Function  | 93.173                       | RO1 DC003552                      | 08/01/98 - 06/30/11 | \$ 289,153       |
| 524  | Cell Cycle in Dev/Regeneration   | 93.173                       | RO1 DC004189                      | 08/01/99 - 11/30/10 | 758,376          |
| 528  | Inner Ear Sensory Organs   | 93.173                       | R55 DC004061                      | 07/01/06 - 06/30/11 | 329,758          |
| 529  | Measures of Otologic Pathways  | 93.173                       | R01 DC03592                       | 07/01/08 - 06/30/11 | 401,261          |
| 555  | Speech Pattern Recognition   | 93.173                       | RO1 DC04993                       | 07/01/01 - 04/30/11 | 359,828          |
| 556  | Innate Immunity in Otitis Medi   | 93.173                       | RO1 DC05025                       | 09/01/01 - 08/31/11 | 322,637          |
| 597  | Training Effects on Adult Coch   | 93.173                       | RO1 DC04792                       | 05/01/01 - 06/30/11 | 472,838          |
| 711  | Cell Cycle in Ototoxin Induced Hair Cell Death   | 93.173                       | RO1 DC007173                      | 07/01/05 - 06/30/11 | 17,697           |
| 753  | Frequency Place Mapping in Cochlear Implants   | 93.173                       | RO1 DC01526                       | 04/15/02 - 03/31/11 | 308,427          |
| 785  | Assessing Auditory Capacity in Hearing Impair Children   | 93.173                       | RO1 DC006238                      | 07/15/03 - 06/30/11 | 205,102          |
| 788  | P30- Engineering Core B  | 93.173                       | P30 DC006276                      | 08/01/03 - 05/31/11 | 280,578          |
| 810  | Cell & Molecular Analysis of Human Temporal Bones  | 93.173                       | U24 DC008625                      | 09/21/06 - 08/31/10 | 736,258          |
| 832  | Role of Spiral Ligament Fibrocytes in Inner Ear  | 93.173                       | R03 DC008696                      | 03/01/08 - 02/28/11 | 168,678          |
| 838  | Dev & Adaptive Behavior of Young Children  | 93.173                       | R01 DC009561                      | 09/01/08 - 08/31/10 | 644,593          |
| 842  | DNA Repair Mechanisms Underlying Hair Cell   | 93.173                       | F32DC010125                       | 03/01/09 - 02/28/11 | 56,186           |
| 846  | Using Current-Focusing and Current-Steering  | 93.173                       | 4R03DC010064-03                   | 06/01/11 - 05/31/12 | 13,698           |
| 848  | Structural Basis of Outer Hair Cell Function   | 93.173                       | 5R01DC010146-02                   | 07/01/09 - 06/30/11 | 382,672          |
| 858  | Hearing Aid Research Conference  | 93.173                       | 1R13DC010537-01                   | 12/01/09 - 11/30/10 | 30,000           |
| 860  | Regulation of Inflammatory Respiratory   | 93.173                       | 1 R01 DC010397-01                 | 12/01/09 - 11/30/10 | 362,519          |
| 873  | Increasing the Number of Effective Channels  | 93.173                       | 1F31DC011205-01                   | 08/17/10 - 08/16/11 | 34,035           |
| 885  | High-Resolution Mapping of Susceptibility  | 93.173                       | 1R01DC010856-01A1                 | 02/01/11 - 01/31/12 | 60,070           |
| Pass-through from Compreval Inc.- Binaural Assessment        |  |                              |                                   |                     |                  |
| 862  | Instrument for Cochlear Implant  | 93.173                       | 1R43DC010510-01                   | 01/01/10 - 12/31/10 | 13,224           |
| 884  | Pass-through from Compreval Inc. -Instrument for Objective<br>Pass-through from John Hopkins University - Childhood        | 93.173                       | 1R43DC010963-01                   | 01/01/11 - 04/30/11 | 10,044           |
| 754  | Development after Cochlear Implant   | 93.173                       | 8206 00394                        | 05/01/02 - 06/30/11 | 160,601          |
| 845  | Pass-through from O-Ray - Pharmacokinetics of Fluticisone<br>Pass-through from University of Iowa - Sub-Multimodal Test of | 93.173                       | R43 DC008477                      | 03/23/09 - 02/01/11 | 6,401            |
| 871  | Spoken Work  | 93.173                       | 1000759637                        | 07/17/09 - 01/31/11 | <u>166,324</u>   |
| <b>Total</b>   |  | <b>93.173</b>                |                                   |                     | <u>6,590,957</u> |
| ARRA - Human Cochlear Function                               |  |                              |                                   |                     |                  |
| 501  | ARRA - Human Cochlear Function   | 93.701                       | 2R01DC003552-09A1                 | 07/17/09 - 06/30/11 | 121,099          |
| 524  | ARRA - Cell Cycle in Dev/Regeneration  | 93.701                       | 3R01DC004189-08S1                 | 08/14/09 - 07/31/11 | 10,863           |
| 529  | ARRA - Speech Pattern Recognition  | 93.701                       | 3R01DC003592-05A2S1               | 07/17/09 - 06/30/11 | 78,791           |
| 555  | ARRA - Speech Pattern Recognition  | 93.701                       | 3R01DC004993-08S1                 | 07/17/09 - 06/30/11 | 111,312          |
| 597  | ARRA - Training Effects on Adult Coch  | 93.701                       | 5R01DC004792-07S1                 | 07/17/09 - 06/30/11 | 98,929           |
| 788  | ARRA - P30 - Engineering Core B  | 93.701                       | 3P30DC006276-06S1                 | 07/17/09 - 06/30/11 | 116,079          |
| 810  | ARRA - Cell & Molecular Analysis of Human Temporal Bones   | 93.701                       | 3U24DC008625-03S2                 | 07/17/09 - 06/30/11 | 109,796          |
| 832  | ARRA - Role of Spiral Ligament Fibrocytes in Inner Ear   | 93.701                       | 3R03DC008696-02S2                 | 09/03/09 - 02/28/11 | 34,118           |
| 846  | ARRA - Using Current-Focusing and Current-Steering   | 93.701                       | 1R03DC010064-01                   | 06/02/09 - 05/31/11 | 187,671          |
| 851  | ARRA - Genetic Analysis of Age Related   | 93.701                       | 1 R01 DC010215-01                 | 09/03/09 - 07/31/11 | 742,961          |
| 853  | ARRA - Jr. Faculty Recruitment into New Auditory   | 93.701                       | 1P30DC010743-01                   | 09/17/09 - 08/31/11 | 843,363          |
| ARRA - Pass-through from University of Cincinnati - Temporal |  |                              |                                   |                     |                  |
| 869  | Processing   | 93.701                       | 1R15DC0110004-01                  | 04/08/10 - 03/31/11 | <u>64,251</u>    |
| <b>Total ARRA</b>  |  | <b>93.701</b>                |                                   |                     | <u>2,519,232</u> |
| Pass-through from University of Southern California -        |  |                              |                                   |                     |                  |
| 879  | Nanosecond Pulsed Plasma Tech  | <b>93.121</b>                | 1R21DE020167-01A1                 | 07/01/10 - 06/30/11 | <u>43,684</u>    |
|  |  |                              |                                   |                     | \$ 9,153,873     |

HOUSE RESEARCH INSTITUTE  
 SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
 FOR THE YEAR ENDED JUNE 30, 2011  
 (Continued)

| HEI<br>Project<br>Number     | Project Name   | Federal<br>Catalog<br>Number | Agency or Pass-<br>through Number | Contract Period     | Expenditures        |
|------------------------------|--|------------------------------|-----------------------------------|---------------------|---------------------|
| <b>Department of Defense</b> |  |                              |                                   |                     |                     |
| 861                          | Mouse Model of Schwannomatosis                                 | 12.420                       | W81XWH-10-1-0070                  | 01/15/10 - 01/14/11 | 91,959              |
|                              | Pass-through from Cincinnati Children's Hospital - Therapeutic |                              |                                   |                     |                     |
| 850                          | Targets for Peripheral Nerve                                   | 12.420                       | CHMC105457M1                      | 03/01/09 - 02/28/10 | <u>80,435</u>       |
|                              | <b>Total</b>   | <b>12.420</b>                |                                   |                     | <u>172,394</u>      |
|                              |  |                              |                                   |                     | <u>\$ 9,326,267</u> |

**HOUSE RESEARCH INSTITUTE  
NOTES TO THE SCHEDULE OF FEDERAL FINANCIAL ASSISTANCE  
FOR THE YEAR ENDED JUNE 30, 2011**

**Note 1 - Significant Accounting Policies**

**Basis of Presentation**

The accompanying Schedule of Expenditures of Federal Awards includes all federal grants to House Research Institute (Institute) which had activity during fiscal 2011. 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 Expenditures of Federal Awards. Below is the reconciliation of the reportable Schedule of Expenditures of Federal Awards to the Institute's audited financial statements.

|   |                                |
|---|--------------------------------|
| Total Grant Expenditures per Schedule of Federal Financial Assistance   | \$ 9,326,267                   |
| Other Grants  |                                |
| Children's Tumor Foundation   | 237,696                        |
| Schwartz Foundation   | 75,577                         |
| O-Ray   | 42,869                         |
| Creare Inc.   | 42,594                         |
| Bundy Foundation  | 37,149                         |
| Deafness Research Foundation  | 29,867                         |
| Otonomy   | 21,102                         |
| Oticon  | 11,011                         |
| Miscellaneous consulting  | <u>17,077</u>                  |
| <br>Total Grants and Contracts Revenue per Audited Financial Statements | <br><u><u>\$ 9,841,209</u></u> |

**SINGLE AUDIT**



# HENSIEK & CARON

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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 Research Institute

We have audited the financial statements of House Research Institute as of and for the year ended June 30, 2011, and have issued our report thereon dated October 7, 2011. 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 7, 2011



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## **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 Research Institute

### **Compliance**

We have audited House Research 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, 2011. 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 Research 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, 2011.

### **Internal Control Over Compliance**

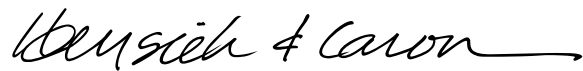
Management of the Organization is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Organization's internal control 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.

A handwritten signature in cursive script, appearing to read "Wenzel & Caron", with a long horizontal flourish extending to the right.

October 7, 2011

**HOUSE RESEARCH INSTITUTE  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
JUNE 30, 2011**

**A. SUMMARY OF AUDIT RESULTS**

1. The auditor's report expresses an unqualified opinion on the basic financial statements of the House Research 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 Research 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 Research 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 RESEARCH INSTITUTE  
SCHEDULE OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS  
JUNE 30, 2011**

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

None