

**MOZILLA FOUNDATION AND SUBSIDIARY**

**DECEMBER 31, 2006 AND 2005**

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**INDEPENDENT AUDITORS' REPORT**

**AND**

**CONSOLIDATED FINANCIAL STATEMENTS**

# **Mozilla Foundation and Subsidiary**

## **Independent Auditors' Report and Consolidated Financial Statements**

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### **Independent Auditors' Report**

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### **Consolidated Financial Statements**

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**Independent Auditors' Report**

THE BOARD OF DIRECTORS  
MOZILLA FOUNDATION  
Mountain View, California

We have audited the accompanying consolidated statement of financial position of **MOZILLA FOUNDATION AND SUBSIDIARY (Mozilla)** as of December 31, 2006 and 2005 and the related consolidated statements of activities and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of Mozilla's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Mozilla Foundation and Subsidiary as of December 31, 2006 and 2005, and the changes in their net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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September 28, 2007

# Mozilla Foundation and Subsidiary

## Consolidated Statement of Financial Position

<i>December 31,</i>	<i>2006</i>	<i>2005</i>
<b>Assets</b>		
<b>Cash and cash equivalents</b>		
Cash and cash equivalents	\$ 13,156,912	\$ 36,405,598
Receivables	6,833,191	5,318,714
Prepays	711,070	74,380
Deferred taxes	1,204,294	509,190
Investments	50,842,504	9,125,732
Furniture and equipment, net	1,285,122	898,773
Deposits	115,617	64,000
 Total assets	 74,148,710	 \$ 52,396,387
 <b>Liabilities and Net Assets</b>		
<b>Liabilities:</b>		
Accounts payable and accrued liabilities	2,317,297	\$ 1,346,632
Income tax payable	8,463	7,774,040
Deferred revenue		137,500
Unrecognized income tax benefits	14,041,000	13,250,000
 Total liabilities	 16,366,760	 22,508,172
<b>Net Assets:</b>		
Unrestricted	57,781,950	29,888,215
 Total net assets	 57,781,950	 29,888,215
 Total liabilities and net assets	 \$ 74,148,710	 \$ 52,396,387

## Mozilla Foundation and Subsidiary

### Consolidated Statement of Activities and Changes in Net Assets

<i>Years Ended December 31,</i>	<b>2006</b>	<b>2005</b>
<b>Revenues and Other Support:</b>		
Royalties - search	\$ 61,501,145	\$ 50,516,268
Royalties - product sales	94,590	171,329
Product revenues	1,000,416	841,138
Contracted services	137,500	356,500
Contributions	92,602	493,867
Interest income	2,162,756	577,351
Other income	60,351	12,593
Unrealized gain (loss) from investments	1,791,490	(62,444)
 Total revenue and support	 66,840,850	 52,906,602
 <b>Expenses:</b>		
Program services	540,384	
Software development	11,775,516	6,075,474
Sales and marketing	4,836,238	768,701
General and administrative	2,624,055	1,328,353
 Total expenses	 19,776,193	 8,172,528
 <b>Change in Net Assets before Provision for Income Taxes</b>	 47,064,657	 44,734,074
Provision for income taxes	19,170,922	18,614,850
 <b>Change in Net Assets</b>	 27,893,735	 26,119,224
 <b>Net Assets</b> - beginning of year	 29,888,215	 3,768,991
 <b>Net Assets</b> - end of year	 \$ 57,781,950	 \$ 29,888,215

# Mozilla Foundation and Subsidiary

## Consolidated Statement of Cash Flows

<i>Years Ended December 31,</i>	<b>2006</b>	<b>2005</b>
<b>Cash Flows from Operating Activities:</b>		
Change in net assets	\$ 27,893,735	\$ 26,119,224
Adjustments to reconcile change in net assets to net cash provided by operations:		
Depreciation	607,578	162,876
Unrealized (gain)/loss on investments	(1,791,490)	62,444
Change in deferred taxes	(695,104)	(509,190)
Changes in assets and liabilities:		
Receivables	(1,515,421)	(1,344,747)
Prepays and other assets	(636,690)	(74,380)
Deposits	(51,617)	(64,000)
Accounts payable and accrued expenses	970,665	1,188,147
Income tax payable	(7,765,577)	7,774,040
Deferred revenue	(137,500)	137,500
Unrecognized income tax benefits	791,000	11,355,000
Due to/from related parties	944	(6,696)
Net cash provided by operating activities	17,670,523	44,800,218
<b>Cash Flows from Investing Activities:</b>		
Purchases of furniture and equipment	(993,927)	(962,729)
Purchases of investments	(74,501,352)	(10,188,176)
Proceeds from sale of investments	34,576,070	1,000,000
Net cash used by investing activities	(40,919,209)	(10,150,905)
<b>Net (Decrease) Increase in Cash and Cash Equivalents</b>	<b>(23,248,686)</b>	<b>34,649,313</b>
<b>Cash and Equivalents - Beginning of year</b>	<b>36,405,598</b>	<b>1,756,285</b>
<b>Cash and Equivalents - End of year</b>	<b>\$ 13,156,912</b>	<b>\$ 36,405,598</b>

### **Supplemental Disclosure:**

Cash paid for income taxes	\$ 26,777,000	\$ 31,000
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# Mozilla Foundation and Subsidiary

## Notes to Financial Statements

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### Note 1 - Nature of the Organization:

Established in July 2003, the Mozilla Foundation (the Foundation) is a California not-for-profit corporation that exists to provide organizational, legal, and financial support for the Mozilla open-source software project. The Foundation's purpose is to develop open source, standards compliant, free Internet applications that will be useable free of charge to tens of millions of users. In addition, its purpose is to develop foundational technologies that will be used by content and software developers to develop standards compliant online content and open source internet software.

In August 2005, the Foundation launched a wholly owned subsidiary, the Mozilla Corporation (the Corporation.) The Corporation is a taxable subsidiary that serves the non-profit, public benefit goals of its parent, the Foundation, and is responsible for product development, marketing and distribution of Mozilla products. The activities of the Foundation related to sponsorship contracts, contracted services and the affiliate program were assigned to the new corporation. The employees were also transferred to the new corporation. The Foundation retained the product royalty contract and continues to receive contributions.

### Note 2 - Summary of Significant Accounting Policies:

#### a. Principles of Consolidation

The consolidated financial statements include the accounts of the Foundation and the Corporation (collectively Mozilla.) All significant intercompany transactions have been eliminated.

#### b. Basis of Presentation

Net assets, revenues, expenses, gains and losses are classified based on the existence or absence of donor imposed restrictions. Since no donor restrictions exist on the Foundation's net assets, all of the net assets are classified as unrestricted.

#### c. Cash and Cash Equivalents

For purposes of the statement of cash flows, Mozilla considers its operating checking accounts to be cash and cash equivalents.

#### d. Receivables

Receivables consist primarily of amounts due from contracts with the search engine providers and the Amazon affiliates program. An allowance for uncollectible receivables is provided based upon prior history and management's assessment of collectibility. No allowance has been deemed necessary for any receivables.

## Mozilla Foundation and Subsidiary

### Notes to Financial Statements

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#### e. Investments

Investments, which consist of money funds, common stock, mutual funds, government bonds, commercial paper, corporate debentures, U.S. Agency-Discount Notes and deposits are stated at market value, based upon quoted market prices. Changes in market value are recognized on a current basis in the statement of activities.

#### f. Furniture and Equipment

Furniture and equipment are stated at cost. Contributed equipment is recorded at fair value at the date of donation. Depreciation is calculated over the estimated useful lives of the related assets using the straight-line method. Leasehold improvements are amortized over the useful life or the term of the lease, whichever is shorter.

#### g. Recognition of Revenue

*Royalties:* Mozilla receives income from contracts with various search engine providers. Revenue from these contracts is determined by the search engine provider based upon its activity. In addition, Mozilla receives royalties from the sale of various products on its website. Mozilla records revenue based upon the amounts received, with the revenue recorded on the accrual basis.

*Product revenues:* Mozilla has a contract with Amazon under the Amazon's affiliates program. Mozilla records revenue based upon amounts received, with revenue recorded on the accrual basis.

*Contracted services:* Revenues under service agreements are recognized over the contracted service period if a term agreement or as earned if under specific services agreement.

#### h. Contributions

Contributions are recorded at fair value when the donor makes an unconditional promise to give. Contributions collected by third parties are recorded as revenue when received by the third party. Donor-restricted contributions are reported as an increase in temporarily or permanently restricted net assets, depending on the nature of the restriction. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the Statement of Activities as net assets released from restrictions. Contributions that are restricted by the donor are reported as increases in unrestricted net assets if the restrictions expire in the same year in which the contributions are recognized.

Dues for the Tech Advisory Group have been recorded as contributions.

# Mozilla Foundation and Subsidiary

## Notes to Financial Statements

### i. Software Development Costs

Mozilla develops open source software which is available free of charge to users. In addition, due to the open source nature of the development, there is generally no passage of time between achievement of technological feasibility and the availability for general release. Therefore, Mozilla expenses the cost of software development as incurred.

### j. Advertising costs

Mozilla expenses advertising costs as incurred.

### k. Grants

Grants are recorded when approved by the Board and all significant conditions are met.

### l. Income Taxes

In July 2004, the Foundation received its advance ruling as a public benefit charitable organization exempt from income taxes on related income under Section 501(c)(3) of the Internal Revenue Code and applicable sections of the California Revenue and Taxation Code.

The Foundation provides for tax on its unrelated business income which consists of revenue from the Amazon affiliates program.

The Foundation follows Financial Accounting Standards Interpretation No. 48 (FIN 48) *Accounting for Uncertainty in Income Taxes*. See note 5.

The Corporation is a C corporation. Income taxes are accounted for using an asset and liability approach, which requires the recognition of deferred tax liabilities and assets for the expected future tax consequences of temporary differences between the financial statement and tax basis of assets and liabilities at the applicable enacted tax rates. The differences relate primarily to state taxes.

### m. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions. Actual results could differ from those estimates.

### n. Functional Expenses

Expenses are allocated to functional areas based on management's estimates. There were no direct fundraising expenses incurred and the incidental expenses, such as the website, were immaterial. Program services include costs related to furthering the Mozilla open-source project. Grants totaling \$220,532 are included in program services.

# Mozilla Foundation and Subsidiary

## Notes to Financial Statements

### Note 3 – Investments

At December 31, 2006 and 2005 investments consist of the following:

	2006	2005
Common Stock	\$ 12,513,951	
Closed End Funds	224,300	
Mutual Funds	3,237,778	
Government Bonds	4,576,688	
Money Market Fund	7,585,307	
Commercial Paper	10,619,670	
US Agency Funds	4,370,901	
Fixed Income Funds	988,107	
Corporate Debentures	4,174,683	
Certificate of Deposit	2,551,119	
Institutional Diversified Assets (money fund)		\$ 4,094,338
Institutional Short/Intermediate bond fund		5,031,394
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	\$ 50,842,504	\$ 9,125,732

### Note 4 - Furniture and Equipment:

Furniture and equipment as of December 31, 2006 and 2005 are as follows:

	2006	2005	Useful Life (Years)
Computer equipment	\$ 1,572,831	\$ 884,299	3
Furniture and office equipment	153,558	132,862	7
Leasehold improvements	48,979	43,030	4
Software	308,871	30,120	3
	<hr/>	<hr/>	<hr/>
	2,084,239	1,090,311	
<u>Less accumulated depreciation</u>	<u>(799,117)</u>	<u>(191,538)</u>	
	<hr/>	<hr/>	<hr/>
<u>Net furniture and equipment</u>	<u>\$ 1,285,122</u>	<u>\$ 898,773</u>	

## Mozilla Foundation and Subsidiary

### Notes to Financial Statements

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#### Note 5 - Income Taxes:

The Mozilla Foundation received revenue from various search engine providers in exchange for being included in Mozilla's Firefox web browser. These contracts were transferred to the Mozilla Corporation in August 2005. Management, having received a tax opinion from its legal counsel with respect to the contract that is the source of most of the revenue, believes that the revenue constitutes royalties as defined in the Internal Revenue Code. Therefore, it would not be unrelated business taxable income, subject to income taxes. However, there is no direct authority involving similar payments for such e-commerce activities for not-for-profit organizations.

Management follows the provisions of *FAS Interpretation No.48 (FIN 48) Accounting for Uncertainty in Income Taxes*. Under FIN 48, an entity must determine whether it is more likely than not that a tax position will be sustained upon examination, including resolution of any appeals or litigation processes, based upon the technical merits of the position. Due to the lack of directly related case law, management cannot conclude that it is more likely than not that the Internal Revenue Service would concur with the Foundation's position. Therefore, in accordance with FIN 48, the Foundation has accrued a liability for unrecognized tax benefits related to the revenue received by the Foundation from the search providers.

A reconciliation of unrecognized tax benefits as of the beginning and end of the year is as follows:

	2006	2005
Balance at January 1	\$ 13,250,000	\$ 1,895,000
Additions based upon tax positions related to the current year	11,281,000	
Additions for interest due on liabilities from the prior year	791,000	74,000
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Balance at December 31	<hr/> \$ 14,041,000	<hr/> \$ 13,250,000

The Foundation accrues interest related to unrecognized tax benefits due from the prior year as part of the tax expense. However, due to the fact that the Foundation believes it has substantial authority for its position, it has not accrued for any penalties.

## Mozilla Foundation and Subsidiary

### Notes to Financial Statements

The Foundation received the royalty revenue in 2004 and 2005. These years are open to examination. It is not expected that there will be any significant increase or decrease in the unrecognized tax benefits in the next year unless there is an examination of the issue.

The Foundation also receives revenue from its affiliate program which is considered to be unrelated business taxable income. This affiliate program has two parts, the most significant of which was transferred to the Corporation. Therefore, the remaining part is minimal and the Foundation has not accrued any taxes on this source of revenue for 2006.

The provision for income taxes for 2006 and 2005 are comprised of the following:

	2006	2005
Currently payable:		
Corporation income taxes	\$ 19,075,026	\$ 7,622,040
Foundation taxes on the affiliate program	147,000	
Deferred:		
Corporation – related to state taxes	(695,104)	(509,190)
Unrecognized tax benefits, including interest	791,000	11,355,000
 Total provision for income taxes	 \$ 19,170,922	 \$ 18,614,850

#### Note 6 - Related Party Transactions:

##### a. Grants

During 2006, the Foundation awarded a grant for \$30,000 to another foundation, at which time the Chairman of the Board of the Foundation was also a board member of the grantee foundation.

##### b. Shared Expenses

During part of 2005, the Foundation contracted with a for-profit company to provide back-office support and services. The sole owner of this company is the Chairman of the Foundation. For 2005, the total amount charged for such services was \$50,659. All amounts reimbursed were based upon the cost to the for-profit company and allocated based upon estimates of time or usage. These transactions were reviewed in advance by the Board of Directors to insure that the costs were fair and reasonable and did not exceed market rates.

## Mozilla Foundation and Subsidiary

### Notes to Financial Statements

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#### c. Affiliates

The Corporation works with affiliates in Japan and Europe to perform their marketing and public relations, as well as other administrative functions. In exchange for these services, the Corporation pays these affiliates certain amounts, which were \$1,250,602 and \$246,756 in 2006 and 2005, respectively. These are recorded as expenses in the statement of activities.

Accounts receivable includes \$100,000 due from Mozilla Japan.

#### **Note 7 - Retirement Plan:**

The Foundation and the Corporation have defined contribution plans covering substantially all employees. The Foundation and the Corporation contribute an amount equal to 4% and 3% of the employee's qualified salary plus an additional discretionary percent of their qualified salary. Contributions to the plans totaled \$470,402 and \$199,700 for 2006 and 2005.

#### **Note 8 - Concentrations of Risk:**

Mozilla has a contract with a search engine provider for royalties. The contract originally expired in November 2006 but was renewed for two years and expires in November 2008. Approximately 85% of Mozilla's revenue for 2006 was derived from this contract.

Mozilla has defined its financial instruments which are potentially subject to credit risk as cash and investments. At December 31, 2006, essentially all of the cash and investments are in excess of the federally insured limits.

## Mozilla Foundation and Subsidiary

### Notes to Financial Statements

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#### Note 9 - Commitments and Contingencies:

##### *Commitments*

The Corporation leases office space under a lease which expires in October 2009. The corporation provides space to the Foundation at no charge. Rent expense for 2006 totaled \$479,236. Future minimum lease commitments are as follows:

Year Ended,	
2007	\$ 564,731
2008	589,423
2009	456,453
	<hr/>
	\$ 1,610,607

##### *Contingencies*

The Foundation has not accrued for any potential penalties related to unrecognized income tax benefits as described in Note 5.

The Foundation is in its advance ruling period as a public benefit corporation. The ruling period ends December 31, 2007 at which time it will be required to submit information for its public support test. If it does not pass the public support test, the Foundation would be ruled to be a private foundation subject to excise tax at 2% on its net investment income.