Mozilla Foundation and Subsidiary

December 31, 2007 and 2006

Independent Auditors' Report

and

Consolidated Financial Statements

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HOOD & STRONG LLP
CERTIFIED PUBLIC ACCOUNTANTS

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, 2007 and 2006 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, 2007 and 2006, 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.

Hood & Strong LLP

September 19, 2008

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Mozilla Foundation and Subsidiary

Consolidated Statement of Financial Position

December 31,	2007	2006
Assets		
Cash and cash equivalents	$ 18,686,618	$ 13,156,912
Receivables	7,329,390	6,833,191
Prepaids	1,095,168	711,070
Deferred taxes	1,396,729	1,204,294
Investments	68,847,453	50,842,504
Furniture and equipment, net	1,618,006	1,285,122
Deposits	381,415	115,617
Total assets	$ 99,354,779	$ 74,148,710
Liabilities and Net Assets		
Liabilities:		
Accounts payable and accrued liabilities	$ 1,766,987	$ 2,317,297
Income taxes payable	495,153	8,463
Unrecognized income tax benefits	14,832,000	14,041,000
Total liabilities	17,094,140	16,366,760
Net Assets:		
Unrestricted	82,255,557	57,781,950
Temporarily restricted	5,082	
Total net assets	82,260,639	57,781,950
Total liabilities and net assets	$ 99,354,779	$ 74,148,710

Mozilla Foundation and Subsidiary

Consolidated Statement of Activities and Change in Net Assets

Years Ended December 31, 2007 and 2006

	2007			
	Unrestricted	Temporarily Restricted	Total	2006 Total
Revenues and Other Support:				
Royalties - search	$ 68,238,803		$ 68,238,803	$ 61,561,496
Royalties - product sales	76,127		76,127	94,590
Product revenues	1,720,623		1,720,623	1,000,416
Contracted services				137,500
Contributions	47,143	$ 5,082	52,225	92,602
Interest and dividend income	3,264,249		3,264,249	2,162,756
Net realized and unrealized gain from investments	1,778,695		1,778,695	1,791,490
Total revenue and support	75,125,640	5,082	75,130,722	66,840,850
Expenses:				
Program:				
Program services	1,152,330		1,152,330	540,384
Software development	20,735,583		20,735,583	11,775,516
Support:				
Branding and marketing	6,332,459		6,332,459	4,836,238
General and administrative	5,107,483		5,107,483	2,624,055
Total expenses	33,327,855		33,327,855	19,776,193
Change in Net Assets before Provision for Income Taxes	41,797,785	5,082	41,802,867	47,064,657
Provision for income taxes	17,324,178		17,324,178	19,170,922
Change in Net Assets	24,473,607	5,082	24,478,689	27,893,735
Net Assets - beginning of year	57,781,950		57,781,950	29,888,215
Net Assets - end of year	$ 82,255,557	$ 5,082	$ 82,260,639	$ 57,781,950

Mozilla Foundation and Subsidiary

Consolidated Statement of Cash Flows

Years Ended December 31,	2007	2006
Cash Flows from Operating Activities:		
Change in net assets	$ 24,478,689	$ 27,893,735
Adjustments to reconcile change in net assets to net cash provided by operations:		
Depreciation	836,050	607,578
Net realized and unrealized gain on investments	(1,778,695)	(1,791,490)
Change in deferred taxes	(192,435)	(695,104)
Loss on disposal of fixed assets	1,188	
Changes in assets and liabilities:		
Receivables	(496,199)	(1,515,421)
Prepaids	(384,098)	(636,690)
Deposits	(265,798)	(51,617)
Accounts payable and accrued expenses	(550,310)	970,665
Income taxes payable	486,690	(7,765,577)
Deferred revenue		(137,500)
Unrecognized income tax benefits	791,000	791,000
Due to/from related parties		944
Net cash provided by operating activities	22,926,082	17,670,523
Cash Flows from Investing Activities:		
Purchases of furniture and equipment	(1,170,122)	(993,927)
Purchases of investments	(83,643,254)	(74,501,352)
Proceeds from sale of investments	67,417,000	34,576,070
Net cash used by investing activities	(17,396,376)	(40,919,209)
Net Increase (Decrease) in Cash and Cash Equivalents	5,529,706	(23,248,686)
Cash and Cash Equivalents - Beginning of year	13,156,912	36,405,598
Cash and Cash Equivalents - End of year	$ 18,686,618	$ 13,156,912
Supplemental Disclosure:		
Cash paid for income taxes	$ 16,140,000	$ 26,777,000

The accompanying notes are an integral part of this statement.

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. In 2007, the Corporation formed Mozilla Online, Ltd., a wholly-owned Chinese subsidiary, to further its mission in China.

Mozilla Europe and Mozilla Japan are independent organizations contracted by the Corporation to provide marketing and development services and promote the use of Mozilla products in their respective geographic regions. They have been granted the right to use the Mozilla name by the Foundation. Neither the Foundation nor the Corporation have any controlling interest in these organizations.

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.

Unrestricted net assets represent unrestricted resources available to support the operations and temporarily restricted resources which become available for use by Mozilla in accordance with the intentions of donors.

Temporarily restricted net assets represent contributions that are limited in use by the Foundation in accordance with temporary donor imposed stipulations. These stipulations may expire with time or may be satisfied and removed by the actions of the Foundation according to the terms of the contribution. Upon satisfaction of such stipulations, the associated net assets are released from temporarily restricted net assets and recognized as unrestricted net assets. If a restriction is fulfilled in the same fiscal year in which the contribution is received, the Foundation classifies the support as unrestricted.

Permanently restricted net assets represent contributions to be held in perpetuity as directed by the donor. The Foundation does not have any permanently restricted net assets.

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 related to royalties and product revenues. 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.

e. Investments

Investments, which consist of marketable equity and debt securities, are stated at fair value, based upon quoted market prices. Changes in fair 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.

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. See note 9.

Mozilla 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 and prepaid expenses.

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 $690,293 are included in program services.

o. New Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement No. 157, *Fair Value Measurements* (SFAS No. 157), which addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure purposes under generally accepted accounting principles (GAAP). SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, except for nonfinancial assets and nonfinancial liabilities of which the effective date has been delayed for one year.

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115* (SFAS No. 159), which permits entities to choose to measure financial instruments and certain other items at fair value that are not currently required to be measured at fair value. SFAS No. 159 is effective for fiscal years that begin after November 15, 2007.

Mozilla is currently evaluating the impact the aforementioned statements will have on the consolidated financial statements. It does not believe that the adoption of SFAS No. 157 and SFAS No. 159 will have a material impact on its financial position and changes in net assets.

Note 3 - Investments

At December 31, 2007 and 2006 investments consist of the following:

	2007	2006
Money Market Funds	$ 4,764,006	$ 7,585,307
Certificate of Deposit		2,551,119
Common Stock	15,698,996	12,513,951
Mutual Funds	3,603,246	3,462,078
Government Bonds	4,995,856	4,576,688
Commercial Paper	10,176,249	10,619,670
US Agency Funds	1,593,422	4,370,901
Municipal Bonds	13,994,373	
Fixed Income Funds	2,906,131	988,107
Corporate Debentures	11,115,174	4,174,683
	$ 68,847,453	$ 50,842,504

Note 4 - Furniture and Equipment:

Furniture and equipment as of December 31, 2007 and 2006 are as follows:

	2007	2006	Useful Life (Years)
Computer equipment	$ 2,508,836	$ 1,572,831	3
Furniture and office equipment	336,818	153,558	7
Leasehold improvements	59,324	48,979	4
Software	347,007	308,871	3
	3,251,985	2,084,239	
Less accumulated depreciation	(1,633,979)	(799,117)	
Net furniture and equipment	$ 1,618,006	$ 1,285,122	

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 (IRS) 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:

	2007	2006
Balance at January 1	$ 14,041,000	$ 13,250,000
Additions for interest due on liabilities from the prior year	791,000	791,000
Balance at December 31	$ 14,832,000	$ 14,041,000

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. As of December 31, 2007 a total of $1,656,000 of interest has been accrued as part of the unrecognized income tax benefits in the Statement of Financial Position.

The Foundation received the royalty revenue in 2004 and part of 2005. These years are open to examination and the IRS is currently auditing these years for the Foundation. Thus, it is probable that within the next 12 months, the Foundation will know the position of the IRS with respect to this revenue. However, it is still not possible to predict the outcome and if there would be a significant change in the amount recorded.

In addition, the IRS is currently auditing the Corporation for 2005 and is challenging certain deductions. No provision for unrecognized income tax benefits under FIN 48 have been made as management believes it is more likely than not that the company will prevail in its position.

The provision for income taxes for 2007 and 2006 are comprised of the following:

	2007	2006
Currently payable:		
Corporation income taxes	$ 16,836,452	$ 19,075,026
Deferred:		
Corporation – related to state taxes	(303,247)	(695,104)
Unrecognized tax benefits, including interest	791,000	791,000
Total provision for income taxes	$ 17,324,178	$ 19,170,922

Note 6 - Related Party Transactions:

During 2006, the Foundation awarded a grant for $35,000 to another foundation, at which time the Chairman of the Board of the Foundation was also a board member of the grantee foundation.

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 3% of the employee's qualified salary plus an additional discretionary percent of their qualified salary. Contributions to the plans totaled $678,154 and $470,402 for 2007 and 2006.

Note 8 - Concentrations of Risk:

Mozilla has a contract with a search engine provider for royalties which expires in November 2008. The contract was recently amended and extended to November 2011. Approximately 88% and 85% of Mozilla's revenue for 2007 and 2006, respectively, 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, 2007, essentially all of the cash and investments are in excess of the federally insured limits.

In addition, investments in general are exposed to various risks, such as interest rate, credit and overall market volatility. To address these risks, Mozilla maintains an investment policy that sets out performance criteria, investment, and asset allocation guidelines.

Note 9 - Commitments:

The Corporation leases office space under leases which expire through March 2011. The corporation provides space to the Foundation at no charge. Rent expense for 2007 and 2006 totaled $650,849 and $479,236, respectively. Future minimum lease commitments are as follows:

Year Ended,	
2008	$ 648,850
2009	535,688
2010	79,235
2011	19,809
	$ 1,283,582

See Note 11 regarding a new lease agreement.

Note 10 - Contingencies:

As discussed in Note 5, the IRS is currently conducting an audit of both the Foundation and the Corporation. The Foundation has accrued for unrecognized income tax benefits on the search engine revenue under FIN 48 as described in Note 5. The Foundation has not accrued for any potential penalties related to unrecognized income tax benefits as described in Note 5. The IRS has challenged certain expenses of the Corporation. However, management believes that it has substantial authority for its position and has not accrued for any unrecognized income tax benefits under FIN 48.

On the audit of the Foundation there has not been any formal notification of issues. There has been inquiry regarding its tax exemption. Management believes that it is conducting its operations in accordance with its original application for exemption and for which it received the advance ruling as a public benefit corporation.

The Foundation has an advance ruling as a public benefit corporation. The ruling period ended December 31, 2007. It submitted its public support test documentation as required by the advance ruling. While the Foundation did not automatically qualify as a public charity with public support at 33% of total support, it believes that it qualifies as a public charity under the facts and circumstances test with public support over 10%. 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, which is estimated to be approximately $100,000 as of December 31, 2007.

Other than as discussed above, no provisions for unrecognized income tax benefits under FIN 48 have been made for the above issues as management believes that it is more likely than not that it will prevail in its positions.

Note 11 - Subsequent Events:

In January 2008, the Corporation formed a wholly-owned subsidiary Mz Denmark APS.

In February 2008, the Foundation created another for-profit wholly-owned subsidiary, Mozilla Messaging, which develops and markets its email application, Thunderbird. Mozilla Messaging operates out of Canada.

In August 2008, the Corporation signed a new lease agreement for office space. The lease term is five years, with expiration in January 2014. The total lease commitment is estimated to be approximately $8.5 million, excluding shared building expenses.