

Financial Statements and Report of  
Independent Certified Public Accountants  
**Georgia Tech Applied Research Corporation**  
June 30, 2007

# Georgia Tech Applied Research Corporation

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## REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Board of Trustees of  
Georgia Tech Applied Research Corporation:

We have audited the accompanying statement of net assets of the **Georgia Tech Applied Research Corporation** (the Research Corporation), a component unit of the Georgia Tech Research Corporation, as of June 30, 2007, and the related statements of revenues, expenses and changes in net assets, and cash flows for the year then ended. These financial statements are the responsibility of the Research Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America as established by the American Institute of Certified Public Accountants 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Research Corporation's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the 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 the Research Corporation as of June 30, 2007, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 15, 2007, on our consideration of the Research Corporation'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.

The Management's Discussion and Analysis on pages 3 through 4 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

GIZANT TORRENTON LLP

Atlanta, Georgia  
November 15, 2007

# Georgia Tech Applied Research Corporation

## Management's Discussion and Analysis For the Year Ended June 30, 2007

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### Introduction

Effective July 1, 1998, the Georgia Tech Applied Research Corporation (GTARC) was established as a wholly controlled subsidiary of Georgia Tech Research Corporation (GTRC). GTARC was organized as the contracting entity for units of the Georgia Institute of Technology performing research under the cost principles of Office of Management and Budget (OMB) Circular A-122 and Federal Acquisition Regulations (FAR) 31.2.

GTARC enters into contracts and grant agreements with various organizations, including federal agencies, and subcontracts with the Georgia Institute of Technology (GIT) to provide services in connection with these agreements. As part of the relationship, payments occur between GIT and GTARC for certain sponsored project expenditures and research administration.

In a Memorandum of Understanding (MOU) dated April 1, 1953, the Board of Regents of the University System of Georgia authorized GTRC (then GTRI) to serve as the official grantee for all contracts and grants for the conduct of sponsored research at GIT. The MOU also assigned all intellectual property developed through the performance of contracts subcontracted to the Georgia Institute of Technology to GTRC. GTRC and GTARC are the administrative organizations for discoveries, innovations, inventions, patents and copyrights and are responsible for intellectual property management, including patenting and licensing. The ongoing objective of GTARC is to provide services to the Institution and, through those services, to enhance the Institution's programs and goals as a research institution.

### Description of the Financial Statements

The statement of net assets, statement of revenues, expenses and changes in net assets and the statement of cash flows are designed to provide information that will assist in understanding the financial condition and performance of GTARC. The net assets are an indicator of the GTARC's financial health. Over time, increases or decreases in net assets are another measure of the changes in GTARC's financial condition when considered with other non-financial facts.

The statement of net assets presents the assets, liabilities and net assets of GTARC.

The statement of revenues, expenses and changes in net assets presents the revenues earned and the expenses incurred during the year. Activities are reported as either operating or non-operating. The financial reporting model classifies investment earnings and changes in the fair value of investments as non-operating revenues. As a result, the financial statements may show operating losses that are then offset by non-operating revenues from a total financial perspective.

The statement of cash flows presents information in the form of cash inflows and outflows summarized by operating, capital and related financing activities and investing activities.

# Georgia Tech Applied Research Corporation

## Management's Discussion and Analysis For the Year Ended June 30, 2007 (continued)

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### Financial Highlights

The condensed statement of net assets is shown below:

<u>Assets</u>	
Current assets	<u>\$40,641,387</u>
<u>Liabilities and Net Assets</u>	
Current liabilities	\$13,645,156
Net assets – Unrestricted	<u>26,996,231</u>
Total liabilities and net assets	<u>\$40,641,387</u>

Current assets increased by \$1,618,539 or 4.2% from fiscal 2006 due primarily to an increase in research receivables. Research revenue increased which, in turn, increased current receivables.

Current liabilities decreased \$2,849,622 or approximately 1.8% primarily due to an increase in payments to GIT for direct costs incurred.

Net assets represent the difference between GTARC's assets and liabilities. There was an increase of \$4,468,162 or 19.8% which, primarily, can be attributed to increases in operating revenue and investment revenue, which are partially offset by increases in operating expenses.

The condensed statement of revenues, expenses and changes in net assets is shown below:

Operating revenue	\$126,159,942
Operating expenses	<u>122,257,941</u>
Income from operations	3,902,001
Nonoperating revenue, net	<u>566,161</u>
Increase in net assets	4,468,162
Net assets, beginning of year	<u>22,528,069</u>
Net assets, end of year	<u>\$ 26,996,231</u>

Operating revenues consist primarily of research grant revenues. During fiscal 2007, operating revenues were up \$5,237,783 or 4.3% primarily due to increased research project revenues. The increase in operating revenues was partially offset by a slight increase in operating expenses, due to increases in direct research costs resulting from increased research activities.

### Economic Outlook

The Georgia Institute of Technology was awarded \$374 million in sponsored research awards in fiscal year 2007. Ten years ago in fiscal year 1998, awards totaled \$187 million. The funding has doubled in a decade and, by all measures, GIT's research programs are growing. Indicators, including biomedical research, compliance protocols and invention disclosures, reflect this expansion. Biomedical research has blossomed and now accounts for about \$48 million annually in research expenditures. The expenditures and related revenue increased approximately 35% between 2004 and 2007. The economic outlook for GTARC is positive.

# Georgia Tech Applied Research Corporation

## Statement of Net Assets

June 30, 2007

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### Assets

#### Current assets:

Cash and cash equivalents	\$ 8,642,200
Accounts receivable:	
Research contracts – Billed	20,293,625
Research contracts – Unbilled	13,893,831
Other receivables	1,190
Less – Allowance for doubtful accounts	(2,189,459)
Total current assets	<u>\$40,641,387</u>

### Liabilities and Net Assets

#### Current liabilities:

Accounts payable:	
Georgia Institute of Technology	\$10,978,988
Due to component unit	406,816
Other	26
	<u>11,385,830</u>
Deferred research contract revenue	2,259,326
Total current liabilities	<u>13,645,156</u>
<b>Net assets – Unrestricted</b>	<u>26,996,231</u>
Total liabilities and net assets	<u>\$40,641,387</u>

The accompanying notes are an integral part of this financial statement.

# Georgia Tech Applied Research Corporation

## Statement of Revenues, Expenses and Changes in Net Assets For the Year Ended June 30, 2007

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<b>Operating revenues:</b>	
Research contracts	\$126,102,411
Other	57,531
Total operating revenue	<u>126,159,942</u>
<b>Operating expenses:</b>	
Direct costs	120,541,939
Administrative and general expenses	1,600,689
Payments to or on behalf of Georgia Institute of Technology	115,313
Total operating expenses	<u>122,257,941</u>
<b>Income from operations</b>	3,902,001
<b>Nonoperating revenue, net - Interest income</b>	
Total nonoperating revenue, net	<u>566,161</u>
<b>Increase in net assets</b>	4,468,162
<b>Net assets, beginning of year</b>	<u>22,528,069</u>
<b>Net assets, end of year</b>	<u><u>\$ 26,996,231</u></u>

The accompanying notes are an integral part of this financial statement.



# Georgia Tech Applied Research Corporation

## Statement of Cash Flows

For the Year Ended June 30, 2007

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<b>Cash flows from operating activities:</b>	
Receipts from grantors	\$122,734,252
Payments to or on behalf of Georgia Institute of Technology	(115,313)
Payments to suppliers	(124,585,434)
Net cash used in operating activities	<u>(1,966,495)</u>
<b>Cash flows from investing activities – Investment income</b>	566,161
<b>Net decrease in cash and cash equivalents</b>	<u>(1,400,334)</u>
<b>Cash and cash equivalents, beginning of year</b>	10,042,534
<b>Cash and cash equivalents, end of year</b>	<u><u>\$ 8,642,200</u></u>
<b>Reconciliation of operating income to net cash used in operating activities:</b>	
Operating income	\$ 3,902,001
Adjustments to reconcile operating income to net cash used in operating activities:	
Changes in assets and liabilities:	
Provision for bad debts	200,000
Accounts receivable	(3,625,689)
Due to component unit	60,223
Accounts payable to Georgia Institute of Technology	(1,877,594)
Accounts payable other	(2,638)
Deferred research contract revenues	(622,798)
Net cash used in operating activities	<u><u>\$ (1,966,495)</u></u>

The accompanying notes are an integral part of this financial statement.

# Georgia Tech Applied Research Corporation

## Notes to Financial Statements

June 30, 2007

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### Note A – Description of Organization

Georgia Tech Applied Research Corporation (GTARC) was established July 1, 1998, as a wholly controlled subsidiary of Georgia Tech Research Corporation (GTRC). GTARC was organized as the contracting entity for units of the Georgia Institute of Technology (GIT) performing research under the cost principles of OMB Circular A-122 and Federal Acquisition Regulations (FAR) 31.2.

GTARC enters into contracts and grant agreements with various organizations, including federal agencies, and subcontracts with GIT to provide services in connection with these agreements. GTARC is largely a conduit organization, subcontracting performance of all contracts it enters into to GIT. As such, GTARC is an affiliated entity of GIT. As part of the relationship, transfers of funds occur between GIT and GTARC for certain sponsor project expenditures and research administration.

In accordance with Statement No.14, as amended by Statements No. 34 and 39 of the Governmental Accounting Standards Board (GASB) GTRC and GTARC are considered part of the same reporting entity, since they are fiscally interdependent. Accordingly, the accompanying financial statements for GTARC are presented in the financial statements of GTRC as a major fund.

The Board of Regents of the University System of Georgia and Georgia Institute of Technology follow Governmental Accounting Standards Board (GASB) Statement No. 39, “Determining Whether Certain Organizations are Component Units, an amendment of Statement No. 14.” This statement requires the inclusion of the financial statements for foundations and affiliated organizations that qualify as component units in the annual report of the affiliated educational institution. GTRC financial statements, including GTARC as a component unit, are reported as a discretely presented component unit in the Georgia Institute of Technology’s Annual Financial Report.

### Note B – Significant Accounting Policies

The financial statements of GTARC have been prepared in conformity with accounting principles generally accepted in the United States of America and in accordance with Governmental Accounting Standards Board (GASB) Statement No. 20, “Accounting and Financial Reporting for Proprietary Funds, and other Governmental Entities that use Proprietary Fund Accounting” and Statement No. 34, “Basic Financial Statements and Management’s Discussion and Analysis for State and Local Governments.” GTARC follows GASB guidance as applicable to proprietary funds and Financial Accounting Standards Board pronouncements issued on or before November 30, 1989, that do not conflict with GASB pronouncements. The following is a summary of certain significant accounting policies followed in the preparation of the financial statements:

#### Revenue

Substantially all of GTARC's revenues are derived from grants and cost reimbursement contracts that provide for the recovery of direct and indirect costs. GTARC recognizes revenue associated with direct and indirect costs as the related costs are incurred. The recovery of indirect costs is generally recorded at fixed rates negotiated with the sponsoring agency.

# Georgia Tech Applied Research Corporation

## Notes to Financial Statements

June 30, 2007

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### Unbilled Accounts Receivable and Deferred Research Contract Revenue

Unbilled accounts receivable represents costs incurred and charged to projects in excess of amounts invoiced on those projects. Deferred research contract revenue represents amounts invoiced on various projects in excess of costs incurred and charged to those projects.

### Overhead Revenue

GTARC receives reimbursement from sponsoring agencies for indirect costs incurred. GTARC retains a portion of the indirect costs, which is used for operating expenses, and the remainder, with Trustee approval, is generally granted back to GIT in future periods. The overhead revenue is reported as revenue from research contracts in the accompanying financial statements.

### Cash and Cash Equivalents

Cash and cash equivalents are defined as bank deposits and short-term investments with original maturities of less than 90 days. At June 30, 2007, the bank balance was \$1,121,576 and the book balance was \$642,000. GTARC had uninsured and uncollateralized deposits totaling \$1,021,576. At times, cash balances may exceed federally insured amounts. GTARC mitigates this risk by depositing and investing cash with major financial institutions. GTARC has not experienced any loss in such accounts and believes it is not exposed to any significant credit risk on cash. Additionally, subsequent to June 30, 2007, GTARC obtained collateral from the financial institution for deposit amounts exceeding federally insured limits. Cash equivalents are comprised of short-term investments in commercial paper and are stated at cost, which approximates fair value. At June 30, 2007, the fair value of short-term investments was \$8,000,000.

### Major Clients and Concentration of Credit Risk

During the fiscal year ended June 30, 2007, GTARC derived approximately 91% of its revenue from contracts with the U.S. Government. At June 30, 2007, approximately 70% of accounts receivable were from the U.S. Government. Management does not believe these receivables represent significant credit risk at June 30, 2007.

### Federal Income Taxes

GTARC is exempt from income taxes as provided by Section 501(c)(3) of the Internal Revenue Code.

# Georgia Tech Applied Research Corporation

## Notes to Financial Statements

June 30, 2007

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### Allowance for Doubtful Accounts

The allowance for doubtful accounts is determined by evaluating the prior experience, nature of the contract and credit rating of the sponsor for each contract with an outstanding balance greater than 180 days. Generally, all account balances greater than 180 days are reserved. Changes in the allowance for doubtful accounts for the year ended June 30, 2007, was determined as follows:

Beginning balance	\$2,366,851
Recoveries	79,250
Bad debt expense	200,000
Write offs	<u>(456,642)</u>
Ending balance	<u>\$2,189,459</u>

### Grants to Georgia Institute of Technology

Grants of funds are made from time to time to GIT, as authorized by the Board of Trustees. Pursuant to an agreement between GTARC and the Board of Regents of the University System of the State of Georgia, GTARC shall hold in trust all unrestricted net assets for GIT, who shall use such revenue from time to time and in such manner as the Board of Trustees of GTARC may see fit for the promotion of research at GIT.

### Net Assets

Net assets-unrestricted represents resources derived from contracts, grants and fees. These resources are used for the ongoing operations of GTARC and may be used at the discretion of the governing board to meet current expenses for those purposes and to enhance programs at GIT. All of GTARC's net assets are unrestricted.

### Use of Estimates in Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### Note C – Contingent Liabilities

Federal and state funded research projects are subject to special audits. Such audits could result in some allocated costs being disallowed or indirect cost rates adjusted. No provision has been made for any liabilities that may arise from such audits since the amounts, if any, cannot be determined at this time.

# Georgia Tech Applied Research Corporation

## Notes to Financial Statements

June 30, 2007

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### **Note D – Change to Governmental Reporting Model**

Effective July 1, 2006, GTARC implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 34, “Basic Financial Statements and Managements Discussion and Analysis for State and Local Governments” and GASB Statement No. 20, “Accounting and Financial Reporting for Proprietary Funds, and Other Governmental Entities that use Proprietary Fund Accounting.” The change to the Governmental Reporting Model was made as a result of re-examining the procedures for board of trustee appointments and GTARC’s relationship with GTRC and GIT. Previously, GTARC followed financial reporting applicable to not-for-profit organizations. The change to the GASB financial reporting format had no effect on the measurement of assets, liabilities or net assets.