



**GEORGIA TECH APPLIED RESEARCH
CORPORATION**

FINANCIAL STATEMENTS

As of and for the Year Ended June 30, 2016

And Report of Independent Auditor

GEORGIA TECH APPLIED RESEARCH CORPORATION

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Report of Independent Auditor

To the Board of Trustees
Georgia Tech Applied Research Corporation
Atlanta, Georgia

Report on the Financial Statements

We have audited the accompanying financial statement of the business-type activities of the Georgia Tech Applied Research Corporation (“GTARC”), a component unit of Georgia Tech Research Corporation, as of June 30, 2016, and the related statements of revenues, expenses and changes in net position and cash flows for the year then ended and the related notes to the financial statements.

Management’s Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor’s Responsibility

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 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to GTARC’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of GTARC’s internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the net position of the business-type activities of GTARC as of June 30, 2016, and its changes in net position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

OTHER MATTERS

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that management's discussion and analysis on pages 3 through 5 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 6, 2016, on our consideration of GTARC'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. The report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering GTARC's internal control over financial reporting and compliance.

Cherry Bekaert LLP

Atlanta, Georgia
September 6, 2016

GEORGIA TECH APPLIED RESEARCH CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE 30, 2016

Introduction

On July 1, 1998 the Georgia Tech Applied Research Corporation ("GTARC"), a component unit of Georgia Tech Research Corporation ("GTRC"), was established. GTARC is a state-chartered, not-for-profit corporation serving the Georgia Institute of Technology ("GIT"), a unit of the University System of the state of Georgia, as an approved cooperative organization.

GTARC was organized and operates primarily for the purpose of soliciting grants and contracts or accepting grants or entering into contracts for research or services to be performed by or in conjunction with GIT or using GIT's facilities and for related objectives. GTARC serves the business segments of GIT, which perform research in accordance with guidance released by the OMB and Federal Acquisition Regulations ("FAR") 31.2. Awards adhere to guidance contained in Title 2 of the CFR and FAR 31.2. With respect to subsequent incremental funding provided on awards which were received preceding the changes to OMB guidance, GTARC administers the research in accordance with instruction provided by the individual awarding Federal agencies.

Description of the Financial Statements

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

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

The statement of revenues, expenses, and changes in net position 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

JUNE 30, 2016

Financial Highlights

The condensed statements of net position at June 30, 2016 and 2015 are shown below:

	<u>2016</u>	<u>2015</u>
Assets		
Current assets	\$ 98,598,139	\$ 90,179,152
Noncurrent assets	74,152	76,633
Total Assets	<u>98,672,291</u>	<u>90,255,785</u>
Liabilities		
Current liabilities	<u>77,288,984</u>	<u>68,559,695</u>
Net Position		
Invested in capital assets	73,473	76,633
Unrestricted	<u>21,309,834</u>	<u>21,619,457</u>
Total Net Position	<u>\$ 21,383,307</u>	<u>\$ 21,696,090</u>

Current assets increased by \$8,418,987, or approximately 9.3% from fiscal 2015 to 2016, due primarily to an increase in research receivables, which was the result of an increase in research revenues in 2016 compared to 2015.

Current liabilities increased by \$8,729,289, or approximately 12.7%, primarily due to the timing of payments made to GIT.

Net position represents the difference between GTARC's assets and liabilities. There was a decrease of \$312,783, or 1.4%, which can be attributed to an increase in operating expenses.

The condensed statements of revenues, expenses, and changes in net position for the years ended June 30, 2016 and 2015 are shown below:

	<u>June 30,</u>	
	<u>2016</u>	<u>2015</u>
Operating revenues	\$ 358,822,609	\$ 340,870,180
Operating expenses	(359,193,050)	(340,566,330)
Income/(loss) from operations	(370,441)	303,850
Nonoperating revenue, net	57,658	51,368
Increase/(decrease) in net position	(312,783)	355,218
Net position, beginning of year	21,696,090	21,340,872
Net position, end of year	<u>\$ 21,383,307</u>	<u>\$ 21,696,090</u>

Operating revenues consist primarily of research grant revenues. During the fiscal year ended June 30, 2016, operating revenues increased by \$17,952,429, or approximately 5.3%, due to an increase in research activities and funds awarded for research projects.

Operating expenses increased \$18,626,720, or approximately 5.47%, due to increased direct research costs in proportion to an increase in research activities.

GEORGIA TECH APPLIED RESEARCH CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE 30, 2016

Economic Outlook

GIT, through GTRC and GTARC received more than \$718 million in sponsored research awards in fiscal year 2016. Research awards grew in the academic units of GIT. GTRC received over \$351 million in new research funding while GTARC received approximately \$367 million. Overall, new funding for GIT research increased approximately 12.5% over new funding received in 2015.

GIT is working with a diverse set of public and private sponsors to support growth in research with a particular emphasis on engagement with private industry. The development of Research Neighborhoods aligned with the Institute's strategic research themes provides opportunities for educational engagement for students as well as research collaboration. The numbers of master agreements and contracts executed by GTRC and GTARC with private industry has increased as has total funding and average award size. In 2017, the Office of Industry Engagement will work with the Vice Presidents for Research, Corporate Relations, and faculty to focus on building research relationships with strategic research sponsors particularly. Certain areas of research continue to promise opportunities for funding for innovative research. These include cyber security; data analytics and data sciences for which a new Interdisciplinary Research Institute was formed in 2016; and manufacturing including cell based manufacturing. Energy, alternative energy and sustainability continue to be key funding sectors.

GIT is attentive to the extremely competitive environment and slow growth in federal funding in many areas of basic research. The federal government has emphasized the importance of public-private research collaboration which makes the emphasis on relationships with industry sponsors an important part of supporting research at GIT. The Offices of Industry Engagement and Corporate Relations will continue to work with the Vice President for Research to develop major public-private projects aligned with GIT's strategic research themes. Overall new awards for research reflect growth although not uniformly across all sectors. However, awards already made to GTRC and GTARC should sustain research expenditures at GIT at current levels through fiscal year 2017.

Requests for Information

This financial report is designed to provide a general overview of Georgia Tech Applied Research Corporation's finances for all those with an interest in the corporation's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Office of the Controller, Georgia Tech Applied Research Corporation, 505 Tenth Street N.W., Atlanta, Georgia, 30332-0415.

GEORGIA TECH APPLIED RESEARCH CORPORATION
STATEMENT OF NET POSITION

JUNE 30, 2016

ASSETS

Current Assets:

Cash	<u>\$ 29,240,567</u>
Accounts receivable:	
Research contracts - billed	33,803,654
Research contracts - unbilled	37,436,527
Less - allowance for doubtful accounts	<u>(1,882,609)</u>
Accounts receivable, net	<u>69,357,572</u>
Total Current Assets	<u>98,598,139</u>

Noncurrent Assets:

Capital assets, net	73,473
Other assets	<u>679</u>
Total Noncurrent Assets	<u>74,152</u>
Total Assets	<u>98,672,291</u>

LIABILITIES

Current Liabilities:

Accounts payable - Georgia Institute of Technology	67,270,927
Due to Georgia Tech Research Corporation	1,510,008
Funds held on behalf of Georgia Institute of Technology	5,942,549
Unearned research contract revenues	<u>2,565,500</u>
Total Current Liabilities	<u>77,288,984</u>

NET POSITION

Invested in capital assets	73,473
Unrestricted	<u>21,309,834</u>
Total Net Position	<u>\$ 21,383,307</u>

GEORGIA TECH APPLIED RESEARCH CORPORATION
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION

YEAR ENDED JUNE 30, 2016

Operating Revenues:	
Research contracts	<u>\$ 358,822,609</u>
Total Operating Revenues	<u>358,822,609</u>
Operating Expenses:	
Research subcontracted to Georgia Institute of Technology	354,875,032
Depreciation	3,160
Administrative and general expenses	3,734,070
Payments to or on behalf of Georgia Institute of Technology	<u>580,788</u>
Total Operating Expenses	<u>359,193,050</u>
Loss from operations	(370,441)
Nonoperating revenue, interest income	<u>57,658</u>
Decrease in net position	(312,783)
Net position, beginning of year	<u>21,696,090</u>
Net position, end of year	<u>\$ 21,383,307</u>

See accompanying notes to the financial statements.

GEORGIA TECH APPLIED RESEARCH CORPORATION
STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2016

Cash flows from operating activities:

Receipts from grantors	\$ 351,889,389
Payments to or on behalf of Georgia Institute of Technology	(580,788)
Payments for research contract costs	(346,455,206)
Payments to suppliers	<u>(3,731,700)</u>
Net cash provided by operating activities	<u>1,121,695</u>

Cash flows from investing activities:

Investment income	<u>57,658</u>
Net cash provided by investing activities	<u>57,658</u>

Net increase in cash	1,179,353
Cash, beginning of year	<u>28,061,214</u>
Cash, end of year	<u>\$ 29,240,567</u>

Reconciliation of operating loss to net cash provided by operating activities:

Operating loss	\$ (370,441)
Adjustments to reconcile operating loss to net cash provided by operating activities:	
Depreciation	3,160
Changes in assets and liabilities:	
Accounts receivable	(7,239,634)
Other assets	(679)
Due to/from Georgia Tech Research Corporation	1,076,996
Accounts payable to Georgia Institute of Technology	7,505,354
Funds held on behalf of Georgia Institute of Technology	(159,476)
Unearned research contract revenues	<u>306,415</u>
Net cash provided by operating activities	<u>\$ 1,121,695</u>

GEORGIA TECH APPLIED RESEARCH CORPORATION

NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2016

Note 1—Description of organization

Georgia Tech Applied Research Corporation (“GTARC”) was established on July 1, 1998. GTARC was organized as the contracting entity for units of the Georgia Institute of Technology (“GIT”) performing research in accordance with guidance released by the OMB and Federal Acquisition Regulations (“FAR”) 31.2. Awards adhere to guidance contained in Title 2 of the CFR and FAR 31.2. With respect to subsequent incremental funding provided on awards which were received preceding the changes to OMB guidance, GTARC administers the research in accordance with instruction provided by the individual awarding Federal agencies. GTARC is a component unit of the Georgia Tech Research Corporation (“GTRC”). Prior to the formation of GTARC, contracting duties were handled solely by GTRC.

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 has served as a “university-connected research foundation.” 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 GIT to GTRC. GTRC is the administrative organization for discoveries, innovations, inventions, patents, and copyrights and is responsible for intellectual property management including patenting and licensing. Currently, pursuant to the Cooperative Organization Guiding Principles Memoranda of Understanding and the Board of Regents Policy 1905, payments occur between GIT and GTRC and GTARC for certain sponsored project expenditures and research administration. GTRC and GTARC hold in trust for GIT any balances, after the payment of necessary operating costs, for the promotion of research at GIT and for the benefit of research at GIT. Intellectual property created in the course of research and other activities at GIT is assigned to GTRC in accordance with the GIT Intellectual Property Policy.

In accordance with accounting principles generally accepted in the United States of America (“GAAP”) applicable to governments, 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 discretely presented component unit.

Note 2—Summary of significant accounting policies

GTARC’s financial statements have been prepared in accordance with GAAP as prescribed by the Governmental Accounting Standards Board (“GASB”). The financial statements of GTARC have been prepared on the accrual basis of accounting and are presented in conformity with GAAP.

The following is a summary of certain significant accounting policies followed in the preparation of the financial statements:

Revenues – The majority 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 for approved research activities. The recovery of indirect costs is generally recorded at fixed rates negotiated with the sponsoring agency.

GTARC classifies revenues generated from within its normal operating cycle, such as research contracts, as operating income. Revenues that are not generated during the normal operating cycle, such as interest income, are classified as non-operating revenues.

GEORGIA TECH APPLIED RESEARCH CORPORATION

NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2016

Note 2—Summary of significant accounting policies (continued)

Unbilled Accounts Receivable and Unearned Research Contract Revenue – Unbilled accounts receivable represent costs incurred for approved research projects and charged to projects in excess of amounts invoiced on those projects. Unearned research contract revenues represent 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 Board of 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.

Major Clients and Concentration of Credit Risk – During the fiscal year ended June 30, 2016, GTARC derived approximately 98.2% of its revenue from contracts with the U.S. Government. At June 30, 2016, approximately 76.7% of the billed research contracts accounts receivable was from the U.S. Government. Management does not believe these receivables represent a significant credit risk at June 30, 2016.

Cash – At June 30, 2016, the bank balance was \$29,536,867, and the book balance was \$29,240,567. Cash balances usually 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. At June 30, 2016, the bank balance was collateralized by a pool of pledged securities administered under the direction of the Georgia Office of Treasury and Fiscal Services.

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

Grants to Georgia Institute of Technology – Pursuant to an agreement between GTARC and the Board of Regents of the University System of Georgia dated April 1, 1953, the GTARC Board of Trustees will issue grants from time to time as it sees fit for the promotion of research at GIT. These grants will be funded from the balances held in trust for GIT which are reflected in the unrestricted net position of GTARC.

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, 2016 were as follows:

Beginning balance	\$ 1,925,562
Write offs	<u>(42,953)</u>
Ending balance	<u>\$ 1,882,609</u>

Net Position – Unrestricted net position represents resources derived primarily from research contracts and fees. These resources can be used for the ongoing operations of GTARC. However, in accordance with the April 1, 1953, Memorandum of Understanding between GTARC and the Board of Regents of the University System of Georgia, all balances held after the payment of necessary operating costs are to be held in trust for GIT for the promotion of research at GIT. These balances will be returned to GIT in the form of grants, which are made at the discretion of the Board of Trustees of GTARC.

GEORGIA TECH APPLIED RESEARCH CORPORATION

NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2016

Note 2—Summary of significant accounting policies (continued)

Research Administration – During the year ended June 30, 2016, GTARC incurred research administration costs totaling \$3,734,070 for services provided by GTRC, which are listed as general and administrative expenses in the statement of revenues, expenses, and changes in net position.

Use of Estimates in Preparation of Financial Statements – The preparation of financial statements in conformity with GAAP 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.

New Accounting Pronouncements – In February 2015, GASB issued Statement of Governmental Accounting Standards (“SGAS”) No. 72, *Fair Value Measurement and Application*, which prescribes how state and local governments should define and measure fair value. It also prescribes which assets and liabilities should be measured at fair value, and expands disclosures related to fair value measurements. GTRC has adopted SGAS 72 for the year ended June 30, 2016. The implementation of SGAS No. 72 did not result in a change to beginning net position and did not have a significant impact on the financial statements.

Note 3—Contingencies

Federal and state funded research projects are subject to special audits. Such audits could result in some allocated costs being disallowed or some indirect cost rates being 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.

Note 4—Line of credit

On October 4, 2013, GTARC and Bank of America, N.A. (the “Lender”) entered into a Loan Agreement (the “Loan Agreement”). The Loan Agreement provides GTARC with a secured revolving line of credit (“line of credit”) of up to \$2,000,000 at an interest rate of the LIBOR daily floating rate plus 1.00%. The line of credit is unsecured, not subject to early termination penalties and was scheduled to expire on October 3, 2014. On August 4, 2014, GTARC terminated the line of credit. On November 24, 2014, the Loan Agreement was amended (the “Amendment”). The Amendment restated the line of credit and increased the line to \$3,000,000, while extending the expiration date to January 5, 2016. The expiration date was subsequently extended to February 28, 2016. On February 9, 2016, GTARC terminated the line of credit.

During the year ended June 30, 2016, GTARC incurred \$5,708 in various fees related to the line of credit.