

FINANCIAL STATEMENTS AND REPORT OF
INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

GEORGIA TECH APPLIED RESEARCH CORPORATION

Year ended June 30, 2006

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Trustees
Georgia Tech Applied Research Corporation
Atlanta, Georgia

We have audited the accompanying statement of financial position of Georgia Tech Applied Research Corporation (a not-for-profit corporation and wholly-controlled subsidiary of Georgia Tech Research Corporation) as of June 30, 2006, and the related statements of activities and cash flows for the year then ended. These financial statements are the responsibility of Georgia Tech Applied 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 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 significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe 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 Georgia Tech Applied Research Corporation as of June 30, 2006, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note D to the financial statements, certain errors resulting in an understatement of the previously reported intercompany payable as of June 30, 2005 were discovered by Georgia Tech Applied Research Corporation management during the current year. Accordingly, an adjustment has been made to net assets as of July 1, 2005 to correct the error.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 25, 2006 on our consideration of Georgia Tech Applied 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.

Grant Thornton LLP

Atlanta, Georgia
September 25, 2006

Georgia Tech Applied Research Corporation

STATEMENT OF FINANCIAL POSITION

June 30, 2006

ASSETS

CURRENT ASSETS

Cash and cash equivalents (Note B-2)	\$	10,042,534
Accounts receivable:		
Research contracts		18,011,873
Less allowance for doubtful accounts		<u>(2,366,851)</u>
		15,645,022
Research projects in process (Note B-5)		<u>12,928,476</u>
Total assets	\$	<u><u>38,616,032</u></u>

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES

Accounts payable:		
Georgia Institute of Technology	\$	12,856,582
Other		2,663
Intercompany payable		346,593
Deferred research contract revenue (Note B-5)		<u>2,882,124</u>
Total current liabilities		16,087,962

COMMITMENTS AND CONTINGENCIES (Note C)

NET ASSETS - UNRESTRICTED

Net assets designated for research pursuant to Board of Regents Agreement		<u>22,528,070</u>
Total liabilities and net assets	\$	<u><u>38,616,032</u></u>

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

Georgia Tech Applied Research Corporation

STATEMENT OF ACTIVITIES

Year ended June 30, 2006

Gross revenue from research contracts (Note B-1)	\$ 120,922,159
Direct costs	75,882,806
Georgia Institute of Technology overhead charges	43,217,953
	<u>119,100,759</u>
Excess of research revenue over direct costs and Georgia Institute of Technology overhead charges	1,821,400
Other operating revenue (expense), net	(1,073,678)
Administrative and general expenses	<u>(1,878,919)</u>
Operating revenue (expense)	(1,131,197)
Other revenue (expense)	
Interest income	701,680
Miscellaneous income	671
Total other revenue, net	<u>702,351</u>
Change in net assets	(428,846)
Net assets, beginning of year, as restated (Note D)	<u>22,956,916</u>
Net assets, end of year	<u>\$ 22,528,070</u>

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

Georgia Tech Applied Research Corporation

STATEMENT OF CASH FLOWS

Year ended June 30, 2006

Cash flows used in operating activities:	
Change in net assets	\$ (428,846)
Adjustments to reconcile change in net assets to net cash used in operating activities:	
Provisions for bad debts	200,000
Change in net assets and liabilities:	
Increase in accounts receivable	(2,962,021)
Decrease in research projects in process	718,978
Increase in accounts payable	2,299,904
Decrease in accrued liabilities	(1,067,376)
Decrease in intercompany payable	(6,557,109)
Decrease in deferred research contract revenue	<u>(1,840,786)</u>
Net cash used in operating activities	(9,637,256)
Cash and cash equivalents, beginning of year	<u>19,679,790</u>
Cash and cash equivalents, end of year	<u><u>\$ 10,042,534</u></u>

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

Georgia Tech Applied Research Corporation

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

NOTE A - NATURE OF ORGANIZATION

Georgia Tech Applied Research Corporation ("GTARC") was established July 1, 1998 as a wholly-controlled subsidiary of Georgia Tech Research Corporation. GTARC was organized as the contracting arm to engage in sponsored research for scientific purposes for work to be performed by Georgia Tech Research Institute.

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. 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.

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 as applicable to not-for-profit organizations. The following is a summary of certain significant accounting policies followed in the preparation of the financial statements:

1. Revenue

Substantially all of GTARC's revenues are derived from grants and cost reimbursement contracts which provide for the recovery of direct and indirect costs. GTARC recognizes revenue associated with direct and indirect costs as the related costs are incurred. Revenue is recognized on a percentage of completion basis for research contracts which are based on performance or milestone measures. The recovery of indirect costs is generally recorded at fixed rates negotiated with the sponsoring agency.

2. Cash and Cash Equivalents

Cash and cash equivalents consist of demand deposit accounts and highly liquid investments with original maturities of less than 90 days. Cash equivalents are stated at cost, which approximates market value.

3. Major Clients and Concentration of Credit Risk

During the fiscal year ended June 30, 2006, the Corporation derived approximately 80 percent of its revenue from contracts with the U.S. government. At June 30, 2006, approximately 41 percent of accounts receivable were from the U.S. government. Management believes that these amounts are properly reflected at net realizable value and there is no significant credit risk at June 30, 2006.

Georgia Tech Applied Research Corporation

NOTES TO FINANCIAL STATEMENTS - CONTINUED

June 30, 2006

NOTE B - SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

4. Federal Income Taxes

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

5. Research Projects in Process and Deferred Research Contract Revenue

Research contracts in process represent 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.

6. Allowance for Doubtful Accounts

The allowance for doubtful accounts is determined by evaluating the prior experience, nature of the contract, and credit rating of each contracting agency with an outstanding balance greater than 180 days. Generally, all account balances greater than 180 days are reserved. Changes in the Corporation's allowance for doubtful accounts is as follows:

Beginning balance	\$	2,230,545
Recoveries		64,159
Bad debt expense		200,000
Write off's		(127,853)
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Balance June 30, 2006	\$	<u>2,366,851</u>

7. 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 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 audits by grantor agencies. Such audits could result in some allocated costs being disallowed or rate adjusted. Management believes that disallowed costs, if any, would not be material to its financial statements. 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 - CONTINUED

June 30, 2006

NOTE D – PRIOR PERIOD ADJUSTMENT

A restatement of previously reported balances of intercompany payable and net assets is required to correct a prior period error. The restatement had the following effect:

Intercompany payable:

Intercompany payable, June 30, 2005 as previously reported	\$ 1,903,702
Adjustment to correct recording of transfer to GTRC	<u>5,000,000</u>

Intercompany payable, June 30, 2005, as restated	<u><u>\$ 6,903,702</u></u>
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Net assets:

Net assets designated for research pursuant to Board of Regents agreement, June 30, 2005, as previously reported	\$ 27,956,916
Adjustment to correct recording of transfer to GTRC	<u>(5,000,000)</u>

Net assets, June 30, 2005, as restated	<u><u>\$ 22,956,916</u></u>
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