

Georgia Tech Applied Research Corporation
Financial Statements
With
Independent Auditors' Report
For the Year Ended June 30, 2009

Georgia Tech Applied Research Corporation

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Independent Auditors' Report

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 (GTARC), a component unit of Georgia Tech Research Corporation, as of June 30, 2009, 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 GTARC's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the 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 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 respective financial position of GTARC as of June 30, 2009, and the respective changes in financial position and 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 October 8, 2009 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 and not to provide and 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 5 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.

Cherry, Bekaert & Holland, L.L.P.

Atlanta, Georgia
October 8, 2009

Georgia Tech Applied Research Corporation

Management's Discussion and Analysis June 30, 2009

Introduction

Effective July 1, 1998, the Georgia Tech Applied Research Corporation (GTARC) was established as a component unit 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 Office of Management and Budget 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 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 Georgia Tech Research Institute) 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 GIT 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 GIT and, through those services, to enhance GIT's programs and goals as a research institution.

Description of the Financial Statements

The statements of net assets, revenues, expenses and changes in net assets and 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 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 June 30, 2009

Financial Highlights

The condensed statement of net assets at June 30, 2009 and 2008 is shown below:

	<u>2009</u>	<u>Restated 2008</u>
Assets		
Current assets	<u>\$ 57,858,857</u>	<u>\$ 50,555,203</u>
Liabilities and net assets		
Current liabilities	36,784,744	29,305,792
Unrestricted net assets	<u>21,074,113</u>	<u>21,249,411</u>
Total liabilities and net assets	<u>\$ 57,858,857</u>	<u>\$ 50,555,203</u>

Current assets increased by \$7,302,654 or 14% from fiscal 2008 due primarily to an increase in research receivables which was the result of an increase in research revenues in 2009 compared to 2008.

Current liabilities increased \$7,478,652 or 26% primarily due to an increase in funds held for GIT.

Net assets represent the difference between GTARC's assets and liabilities. There was a decrease of \$175,298 or 1%, which can primarily be attributed to the increase in research activities which was more than offset by increases in operating expenses.

The condensed statement of revenues, expenses and changes in net assets for the years ended June 30, 2009 and 2008 is shown below:

	<u>2009</u>	<u>Restated 2008</u>
Operating revenues	\$ 162,532,545	\$ 133,740,473
Operating expenses	<u>(162,850,553)</u>	<u>(133,948,295)</u>
Loss from operations	(318,008)	(207,822)
Nonoperating revenue, net	<u>142,710</u>	<u>680,647</u>
(Decrease) increase in net assets	(175,298)	472,825
Net assets, beginning of year	<u>21,249,411</u>	<u>20,776,586</u>
Net assets, end of year	<u>\$ 21,074,113</u>	<u>\$ 21,249,411</u>

Georgia Tech Applied Research Corporation

Management's Discussion and Analysis June 30, 2009

Operating revenues consist primarily of research grant revenues. During the fiscal year ended June 30, 2009, operating revenues were up \$28,792,072 or 22%, due to increased research activities.

Additionally, operating expenses increased \$28,902,258 or 22% primarily due to increased direct research costs resulting from increased research activities.

Economic Outlook

The Georgia Institute of Technology was awarded over \$483 million in sponsored research awards in fiscal year 2009. The funding has doubled in a decade and, by all measures, GIT's research programs are growing. GTARC's interest income has declined due to current economic conditions. However, as the overall economy improves, we anticipate growth in parallel with the national recovery. Those research areas which should see growth are alternative energy, sustainability, biomedical, and nano-technology. It is anticipated that ARRA funding will allow the overall average growth to continue into fiscal years 2010 and 2011 despite likely decreases in awards from private/industry sponsors.

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 Director of Accounting, Georgia Tech Applied Research Corporation, 505 Tenth Street, Atlanta, Georgia, 30332-0415.

Georgia Tech Applied Research Corporation

Statement of Net Assets

June 30, 2009

ASSETS

Current assets:

Cash and cash equivalents	\$ 18,862,325
Accounts receivable:	
Research contracts - Billed	24,626,463
Research contracts - Unbilled	16,456,348
Less - Allowance for doubtful accounts	<u>(2,086,279)</u>
Accounts receivable, net	38,996,532
 Total current assets	 <u><u>\$ 57,858,857</u></u>

LIABILITIES AND NET ASSETS

Current liabilities:

Accounts payable:	
Georgia Institute of Technology	\$ 14,734,693
Other	<u>788,766</u>
Accounts payable	15,523,459
 Due to Georgia Tech Research Corporation	 437,107
 Funds held on behalf of Georgia Institute of Technology	 17,829,883
 Deferred research contract revenues	 <u>2,994,295</u>
 Total current liabilities	 36,784,744
 Unrestricted net assets	 <u>21,074,113</u>
 Total liabilities and net assets	 <u><u>\$ 57,858,857</u></u>

See accompanying notes to financial statements.

Georgia Tech Applied Research Corporation

Statement of Revenues, Expenses and Changes in Net Assets

For the Year Ended June 30, 2009

Operating revenues:	
Research contracts	\$ 162,531,480
Other	1,065
Total operating revenues	<u>162,532,545</u>
Operating expenses:	
Research contract costs	160,993,297
Administrative and general expenses	1,591,888
Payments to or on behalf of Georgia Institute of Technology	265,368
Total operating expenses	<u>162,850,553</u>
Loss from operations	(318,008)
Nonoperating revenue - interest income	<u>142,710</u>
Decrease in net assets	(175,298)
Net assets, beginning of year	31,825,507
Prior period adjustment (Note 5)	<u>(10,576,096)</u>
Net assets, beginning of year (restated)	21,249,411
Net assets, end of year	<u><u>\$ 21,074,113</u></u>

See accompanying notes to financial statements.

Georgia Tech Applied Research Corporation

Statement of Cash Flows

For the Year Ended June 30, 2009

Cash flows from operating activities:	
Receipts from grantors	\$ 155,501,749
Miscellaneous receipts	1,065
Payments to or on behalf of Georgia Institute of Technology	(265,368)
Payments for research contract costs	<u>(155,379,104)</u>
Net cash used in operating activities	<u>(141,658)</u>
Cash flows from investing activity:	
Investment income	<u>142,710</u>
Net cash provided by investing activity	<u>142,710</u>
Net increase in cash and cash equivalents	1,052
Cash and cash equivalents, beginning of year	<u>18,861,273</u>
Cash and cash equivalents, end of year	<u>\$ 18,862,325</u>
Reconciliation of operating loss to net cash used in operating activities:	
Operating loss	\$ (318,008)
Adjustments to reconcile operating loss to net cash used in operating activities:	
Changes in assets and liabilities:	
Accounts receivable	(7,302,602)
Due to Georgia Tech Research Corporation	65,518
Accounts payable to Georgia Institute of Technology	380,860
Accounts payable - other	(494,086)
Funds held on behalf of Georgia Institute of Technology	7,253,789
Deferred research contract revenues	<u>272,871</u>
Net cash used in operating activities	<u>\$ (141,658)</u>

See accompanying notes to financial statements.

Georgia Tech Applied Research Corporation

Notes to Financial Statements

As for and the Year Ended June 30, 2009

NOTE 1 – DESCRIPTION OF ORGANIZATION

Georgia Tech Applied Research Corporation (GTARC) was established July 1, 1998, as a component unit 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 GIT follow Governmental Accounting Standards Board (GASB) Statement No. 39, "Determining Whether Certain Organizations are Component Units, an amendment of Statement No. 14." The State of Georgia has determined that GTRC is significant to the State of Georgia for the year ended June 30, 2009, and as such, is a discretely presented component unit in the Comprehensive Annual Report of the State of Georgia.

NOTE 2 – 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:

Georgia Tech Applied Research Corporation

Notes to Financial Statements

As for and the Year Ended June 30, 2009

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

Unbilled Accounts Receivable and Deferred Research Contract Revenue

Unbilled accounts receivable represents costs incurred for approved research projects 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 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.

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, 2009, the bank balance was \$680,465 and the book balance was \$554,781. 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. At June 30, 2009, bank balances were fully insured by a combination of guarantees from the Federal Deposit Insurance Corporation and the Temporary Liquidity Guarantee Program. Cash equivalents are comprised of short-term investments in money market funds, and are stated at cost, which approximates fair value. The money market fund's underlying investments are comprised of U.S. Treasury Bills, rated AAA by Standard and Poor's, and repurchase agreements, rated P-1 and A-1+, by Moody's and Standard and Poor's, respectively.

Georgia Tech Applied Research Corporation

Notes to Financial Statements

As for and the Year Ended June 30, 2009

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (Continued)

Major Clients and Concentration of Credit Risk

During the fiscal year ended June 30, 2009, GTARC derived approximately 93% of its revenue from contracts with the U.S. Government. At June 30, 2009, approximately 80% of the billed research contracts accounts receivable was from the U.S. Government. Management does not believe these receivables represent significant credit risk at June 30, 2009.

Federal Income Taxes

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

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, 2009 were as follows:

Beginning balance	\$ 2,228,257
Recoveries	1,303
Write offs	<u>(143,281)</u>
Ending Balance	<u>\$ 2,086,279</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 Georgia, dated April 1, 1953, 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

Unrestricted net assets represent resources derived from research contracts 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.

Georgia Tech Applied Research Corporation

Notes to Financial Statements

As for and the Year Ended June 30, 2009

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 3 – INVESTMENTS

GTARC's investments consist of short-term investments in money market funds. At June 30, 2009, these investments totaled \$18,307,544 and are included in cash and cash equivalents in the statement of net assets. At June 30, 2009, short-term investments were uninsured and unregistered, with securities held by the counterparty or by its agent, but not in GTARC's name.

Interest Rate Risk

Interest rate risk is the risk that changes of interest rates of debt investments will adversely affect the fair value of an investment. GTARC does not have a formal policy for managing interest rate risk.

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty to a transaction, GTARC will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. GTARC does not have a formal policy for managing custodial credit risk.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. GTARC does not have a formal policy for managing concentration of credit risk.

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or deposit. GTARC does not have a formal policy for managing foreign currency risk.

Georgia Tech Applied Research Corporation

Notes to Financial Statements

As for and the Year Ended June 30, 2009

NOTE 4 – 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.

NOTE 5 – PRIOR PERIOD ADJUSTMENT

Management of GTARC determined that the amount held for GIT as strategic and other reserves was not reflected appropriately in the financial statement; therefore, during the year ended June 30, 2009 GTARC restated its beginning unrestricted net assets to properly present these amounts. The restatement had the following effect:

Funds held on behalf of GIT:

Funds held on behalf of GIT, June 30, 2008, as previously reported	\$	-
Adjustment to correct recording error		<u>10,576,096</u>

Funds held on behalf of GIT, June 30, 2008, restated	\$	<u>10,576,096</u>
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Net assets - Unrestricted:

Net assets - Unrestricted, June 30, 2008, as previously reported	\$	31,825,507
Adjustment to correct recording error		<u>(10,576,096)</u>

Net assets - Unrestricted, June 30, 2008, restated	\$	<u>21,249,411</u>
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