

Georgia Tech Applied Research Corporation
Financial Statements
With
Independent Auditors' Report
For the Year Ended June 30, 2012

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, 2012, 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, 2012, 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 September 5, 2012 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 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.

Accounting principles generally accepted in the United States of America require that management's discussion and analysis on pages 2 through 4 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 audits 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.

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

Atlanta, Georgia
September 5, 2012

Georgia Tech Applied Research Corporation

Management's Discussion and Analysis

June 30, 2012

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 the 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 the 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 the 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, 2012

Financial Highlights

The condensed statements of net assets at June 30, 2012 and 2011 are shown below:

	<u>2012</u>	<u>2011</u>
Assets		
Current assets	<u>\$ 70,913,620</u>	<u>\$ 61,462,207</u>
Liabilities and net assets		
Current liabilities	\$ 49,693,763	\$ 40,304,219
Unrestricted net assets	<u>21,219,857</u>	<u>21,157,988</u>
Total liabilities and net assets	<u>\$ 70,913,620</u>	<u>\$ 61,462,207</u>

Current assets increased by \$9,451,413 or 15% from fiscal 2011 due primarily to an increase in research receivables which was the result of an increase in research revenues in 2012 compared to 2011.

Current liabilities increased by \$9,389,544 or 23% primarily due to the timing of payments made to the GIT.

Net assets represent the difference between GTARC's assets and liabilities. There was an increase of \$61,689 or less than 1%, which can primarily be attributed to the increase in research activities.

The condensed statements of revenues, expenses and changes in net assets for the years ended June 30, 2012 and 2011 are shown below:

	<u>2012</u>	<u>2011</u>
Operating revenues	\$ 239,229,992	\$ 208,807,788
Operating expenses	<u>(239,186,817)</u>	<u>(208,629,980)</u>
Income from operations	43,175	177,808
Nonoperating revenue, net	<u>18,694</u>	<u>6,030</u>
Increase in net assets	61,869	183,838
Net assets, beginning of year	<u>21,157,988</u>	<u>20,974,150</u>
Net assets, end of year	<u>\$ 21,219,857</u>	<u>\$ 21,157,988</u>

Operating revenues consist primarily of research grant revenues. During the fiscal year ended June 30, 2012, operating revenues increased by \$30,422,204 or 15%, due to increased research activities and expenditures of funds awarded in prior years for research projects and construction.

Additionally, operating expenses increased \$30,556,837 or 15% primarily due to increased direct research costs resulting from increased research activities.

Georgia Tech Applied Research Corporation

Management's Discussion and Analysis

June 30, 2012

Economic Outlook

The Georgia Institute of Technology received a record \$567 million in sponsored research awards in fiscal year 2013 continuing a trend of accelerated growth in external research support. A relatively small portion of the growth in awards is accounted for by funding through the America Recovery and Reinvestment Act (ARRA) and growth would have been positive in the absence of ARRA funding. The conclusion of the stimulus program in 2011 did not unduly influence research funding since a large component of Georgia Tech's ARRA funding involved construction of a new facility. However, there were non-recurring programs funded in FY 12 which will not be conducted in FY 12 and FY 13. Interest earned on deposits remains low due to the prevailing low interest rates on secured deposits. Georgia Tech continues to be proactive in working with a diverse set of public and private sponsors to support growth across a spectrum of topics. Certain areas of research continue to promise opportunities for funding for innovative research. These include energy/alternative energy, medical device innovation, advanced manufacturing, materials and nanomaterials, high performance computing and computational sciences, and medical records informatics. Georgia Tech has aligned Institute Research Centers with these economic areas.

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, Atlanta, Georgia, 30332-0415.

Georgia Tech Applied Research Corporation

Statement of Net Assets

June 30, 2012

ASSETS

Current assets:

Cash	\$ 21,328,369
Accounts receivable:	
Research contracts - Billed	27,253,088
Research contracts - Unbilled	24,263,756
Less - Allowance for doubtful accounts	<u>(1,931,593)</u>
Accounts receivable, net	<u>49,585,251</u>
Total current assets	<u><u>\$ 70,913,620</u></u>

LIABILITIES AND NET ASSETS

Current liabilities:

Accounts payable - Georgia Institute of Technology	\$ 41,224,963
Due to Georgia Tech Research Corporation	288,584
Funds held on behalf of Georgia Institute of Technology	5,416,655
Deferred research contract revenues	<u>2,763,561</u>
Total current liabilities	49,693,763
Unrestricted net assets	<u>21,219,857</u>
Total liabilities and net assets	<u><u>\$ 70,913,620</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, 2012

Operating revenues:	
Research contracts	\$ 239,214,590
Other	<u>15,402</u>
Total operating revenues	239,229,992
Operating expenses:	
Research contract costs	\$ 236,838,595
Administrative and general expenses	2,013,481
Payments to or on behalf of Georgia Institute of Technology	<u>334,741</u>
Total operating expenses	239,186,817
Income from operations	43,175
Nonoperating revenue - interest income	<u>18,694</u>
Increase in net assets	61,869
Net assets, beginning of year	<u>21,157,988</u>
Net assets, end of year	<u><u>\$ 21,219,857</u></u>

See accompanying notes to financial statements.

Georgia Tech Applied Research Corporation

Statement of Cash Flows

For the Year Ended June 30, 2012

Cash flows from operating activities:

Receipts from grantors	\$ 229,440,713
Miscellaneous receipts	15,402
Payments to or on behalf of Georgia Institute of Technology	(334,741)
Payments for research contract costs	<u>(229,462,533)</u>
Net cash used in operating activities	<u>(341,159)</u>

Cash flows from investing activity:

Investment income	<u>18,694</u>
Net cash provided by investing activity	<u>18,694</u>

Net decrease in cash (322,465)

Cash, beginning of year 21,650,834

Cash, end of year \$ 21,328,369

Reconciliation of operating income to net cash used in operating activities:

Operating income	\$ 43,175
Adjustments to reconcile operating income to net cash used in operating activities:	
Changes in assets and liabilities:	
Accounts receivable	(9,773,878)
Due to Georgia Tech Research Corporation	(427,436)
Accounts payable to Georgia Institute of Technology	16,655,370
Funds held on behalf of Georgia Institute of Technology	(6,392,198)
Deferred research contract revenues	<u>(446,192)</u>
Net cash used in operating activities	<u><u>\$ (341,159)</u></u>

See accompanying notes to financial statements.

Georgia Tech Applied Research Corporation

Notes to Financial Statements

As for and the Year Ended June 30, 2012

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 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 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 accounting principles generally accepted in the United States (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 major fund.

The State of Georgia has determined that GTRC is significant to the State of Georgia for the year ended June 30, 2012, and as such, is a discretely presented component unit in the Comprehensive Annual Financial Report of the State of Georgia.

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES

GTARC's financial statements have been prepared in accordance with the accounting principles generally accepted in the United States of America ("GAAP") as prescribed by the Governmental Accounting Standards Board ("GASB"). In accordance with GAAP 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 Financial Statements

As for and the Year Ended June 30, 2012

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

Major Clients and Concentration of Credit Risk

During the fiscal year ended June 30, 2012, GTARC derived approximately 95% of its revenue from contracts with the U.S. Government. At June 30, 2012, approximately 86% 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, 2012.

Cash

At June 30, 2012, the bank balance was \$21,553,443 and the book balance was \$21,328,369. 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, 2012, 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

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.

Georgia Tech Applied Research Corporation

Notes to Financial Statements

As for and the Year Ended June 30, 2012

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES (Continued)

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, 2012 were as follows:

Beginning balance	\$ 1,999,594
Recoveries	-
Write offs	<u>(68,001)</u>
Ending Balance	<u>\$ 1,931,593</u>

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.

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.

NOTE 3 – 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.