

Financial Statements and Report of
Independent Certified Public Accountants

Georgia Tech Applied Research Corporation

June 30, 2008

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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, 2008, 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. 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, 2008, 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.

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.

GRANT THORNTON LLP

Atlanta, Georgia
September 12, 2008

Management's discussion and analysis

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 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, Inc.) 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 and investing activities.

Financial Highlights

The condensed statement of net assets is shown below:

June 30	2008	2007
	\$	\$
Assets--Current assets	50,555,203	40,641,387
Liabilities and net assets		
Current liabilities	18,729,696	13,645,156
Net assets - Unrestricted	31,825,507	26,996,231
Total liabilities and net assets	50,555,203	40,641,387

Current assets increased by \$9,913,816 or 24% from fiscal 2007 due primarily to an increase in cash and cash equivalents resulting from collection of research receivables. Research revenue increased which, in turn, increased current receivables.

Current liabilities increased \$5,084,540 or 37% primarily due to an increase in payables to GIT for direct costs incurred.

Net assets represent the difference between GTARC's assets and liabilities. There was an increase of \$4,829,276 or 18%, which can primarily be attributed to increases in operating revenue and investment income, which are partially offset by increases in operating expenses.

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

June 30	2008	2007
	\$	\$
Operating revenue	142,040,560	126,159,942
Operating expenses	(137,891,931)	(122,257,941)
Income from operations	4,148,629	3,902,001
Nonoperating revenue, net	680,647	566,161
Increase in net assets	4,829,276	4,468,162
Net assets, beginning of year	26,996,231	22,528,069
Net assets, end of year	31,825,507	26,996,231

Operating revenues consist primarily of research grant revenues. During fiscal 2008, operating revenues were up \$15,880,618 or 13%, primarily due to increases in research activities.

Operating expenses were up \$15,633,990 or 13%, primarily due to increased direct research costs resulting from increased research activity.

Economic Outlook

The Georgia Institute of Technology was awarded over \$446 million in sponsored research awards in fiscal year 2008. 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. The economic outlook for GTARC is positive.

Statement of net assets

June 30	2008
	\$
Assets	
Current assets:	
Cash and cash equivalents	18,861,273
Accounts receivable:	
Research contracts – Billed	16,312,651
Research contracts – Unbilled	17,609,536
Less – Allowance for doubtful accounts	(2,228,257)
Net accounts receivable	31,693,930
Total current assets	50,555,203
Liabilities and net assets	
Current liabilities:	
Accounts payable:	
Georgia Institute of Technology	14,353,833
Other	1,282,850
Due to Georgia Tech Research Corporation	371,589
	16,008,272
Deferred research contract revenue	2,721,424
Total current liabilities	18,729,696
Net assets - Unrestricted	31,825,507
Total liabilities and net assets	50,555,203

The accompanying notes are an integral part of this statement.

Statement of revenues, expenses and changes in net assets

For the year ended June 30	2008
	\$
Operating revenues:	
Research contracts	142,038,810
Other	1,750
Total operating revenue	142,040,560
Operating expenses:	
Direct costs	136,310,247
Administrative and general expenses	1,398,552
Payments to or on behalf of Georgia Institute of Technology	183,132
Total operating expenses	137,891,931
Income from operations	4,148,629
Nonoperating revenue - Interest income	680,647
Increase in net assets	4,829,276
Net assets, beginning of year	26,996,231
Net assets, end of year	31,825,507

The accompanying notes are an integral part of this statement.

Statement of cash flows

For the year ended June 30	2008
	\$
Cash flows from operating activities:	
Receipts from grantors	142,342,877
Miscellaneous	2,940
Payments to or on behalf of Georgia Institute of Technology	(183,132)
Payments to suppliers	(132,624,259)
Net cash provided by operating activities	9,538,426
Cash flows from investing activities - Investment income	680,647
Net increase in cash and cash equivalents	10,219,073
Cash and cash equivalents, beginning of year	8,642,200
Cash and cash equivalents, end of year	18,861,273
Reconciliation of operating income to net cash provided by operating activities:	
Operating income	4,148,629
Adjustments to reconcile operating income to net cash used in operating activities - changes in assets and liabilities:	
Accounts receivable	305,257
Due from component unit	(35,227)
Accounts payable to Georgia Institute of Technology	3,374,845
Accounts payable other	1,282,824
Deferred research contract revenues	462,098
Net cash provided by operating activities	9,538,426

The accompanying notes are an integral part of this statement.

Notes to financial statements

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 sponsored 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 State of Georgia, the Board of Regents of the University System of Georgia, and the 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." The State of Georgia has determined that Georgia Tech Research Corporation, which includes GTARC, is significant to the State of Georgia for the year ended June 30, 2008, and as such, is a discretely presented component unit in the Comprehensive Annual Financial Report of the State of Georgia (CAFR).

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:

Revenue

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 grants as operating income. Revenues that are not generated during the normal operating cycle such as interest income are classified by the entity as non-operating revenues.

Unbilled Accounts Receivable and Deferred Research Contract Revenue

Unbilled accounts receivable represent costs incurred for approved research activities 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, 2008, the bank balance was \$5,104,688 and the book balance was \$5,011,273. At times, cash balances may exceed federally insured amounts. GTARC mitigates this risk by depositing and investing cash with major financial institutions and requiring collateral from the financial institution. 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, 2008, bank balances were collateralized by a pool of pledged securities administered under the direction of the Georgia Office of Treasury and Fiscal Services. Cash equivalents are comprised of short-term investments in commercial paper, rated A-1+ and P-1 by Standard & Poors and Moody's, respectively, and are stated at cost, which approximates fair value. At June 30, 2008, the fair value of short-term investments was \$13,850,000.

Major Clients and Concentration of Credit Risk

During the fiscal year ended June 30, 2008, GTARC derived approximately 91% of its revenue from contracts with the U.S. Government. At June 30, 2008, approximately 68% of accounts receivable were from the U.S. Government. Management does not believe these receivables represent significant credit risk at June 30, 2008.

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, 2008, were as follows:

June 30	2008
	\$
Beginning balance	2,189,459
Recoveries	38,798
Bad-debt expense	-
Write offs	-
Ending balance	2,228,257

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, 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

Net assets-unrestricted represent 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 financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

3 Investments

GTARC's investments consist of certain short-term investments in commercial paper. At June 30, 2008, these investments totaled \$13,850,000 and are included in cash and cash equivalents in the statement of net assets. All investments are held exclusively 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's investments are not exposed to foreign currency risk as securities in currencies other than the U.S. dollar are not permissible by GTARC.

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. Management considers the risk of a material settlement resulting from such audits to be remote.