

Houston Advanced Research Center

Consolidated Financial Statements
and Single Audit Reports
for the year ended December 31, 2009

Independent Auditors' Report

To the Board of Directors of
Houston Advanced Research Center:

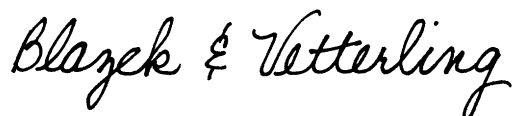
We have audited the accompanying consolidated statements of financial position of Houston Advanced Research Center as of December 31, 2009 and 2008 and the related consolidated statements of activities and of cash flows for the years then ended. These financial statements are the responsibility of the management of Houston Advanced Research Center. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 our audits 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. An audit also includes 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 audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Houston Advanced Research Center as of December 31, 2009 and 2008 and the changes in their net assets and their cash flows for the years 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 a report dated May 15, 2010, on our consideration of Houston Advanced Research Center's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters for the year ended December 31, 2009. 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 read in conjunction with this report in considering the results of our audit.

Our audits were performed for the purpose of forming an opinion on the basic financial statements of Houston Advanced Research Center taken as a whole. The accompanying schedule of expenditures of federal awards for the year ended December 31, 2009 is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. The accompanying schedule of expenditures of state awards for the year ended December 31, 2009 is presented for purposes of additional analysis as required by the *State of Texas Single Audit Circular*, and is not a required part of the basic financial statements. The information in these schedules has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly presented, in all material respects, in relation to the basic financial statements taken as a whole.



May 15, 2010

Houston Advanced Research Center

Consolidated Statements of Financial Position as of December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
ASSETS		
Cash and cash equivalents <i>(Note 2)</i>	\$ 2,416,575	\$ 246,424
Accounts receivable, net of allowance for doubtful accounts of \$35,000 in 2009 and 2008	5,161,343	4,055,110
Pledges receivable <i>(Note 3)</i>	274,718	356,269
Other assets	21,701	18,356
Note receivable from Texas Environmental Research Consortium <i>(Note 4)</i>	300,000	300,000
Prepaid rent <i>(Note 5)</i>	559,375	784,678
Property and equipment, net <i>(Note 6)</i>	<u>499,812</u>	<u>1,324,120</u>
TOTAL ASSETS	<u>\$ 9,233,524</u>	<u>\$ 7,084,957</u>

LIABILITIES AND NET ASSETS

Liabilities:		
Accounts payable	\$ 5,057,062	\$ 3,921,030
Accrued expenses	<u>235,981</u>	<u>328,738</u>
Total liabilities	<u>5,293,043</u>	<u>4,249,768</u>
Net assets:		
Unrestricted	1,075,910	1,665,152
Temporarily restricted <i>(Note 8)</i>	<u>2,864,571</u>	<u>1,170,037</u>
Total net assets	<u>3,940,481</u>	<u>2,835,189</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 9,233,524</u>	<u>\$ 7,084,957</u>

See accompanying notes to consolidated financial statements.

Houston Advanced Research Center

Consolidated Statement of Activities for the year ended December 31, 2009

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>TOTAL</u>
REVENUE:			
Research contracts and grants (<i>Note 9</i>)	\$17,927,702		\$17,927,702
Contributions (<i>Note 12</i>)	1,104,598	\$ 2,638,615	3,743,213
Loss from sale of property and equipment	(334,215)		(334,215)
Other income	<u>39,889</u>	<u> </u>	<u>39,889</u>
Total revenue	18,737,974	2,638,615	21,376,589
Net assets released from restrictions:			
Satisfaction of program restrictions	914,081	(914,081)	
Expiration of time restriction	<u>30,000</u>	<u>(30,000)</u>	<u> </u>
Total	<u>19,682,055</u>	<u>1,694,534</u>	<u>21,376,589</u>
EXPENSES:			
Program expenses:			
Environment	14,306,083		14,306,083
Energy and Building Solutions	3,160,384		3,160,384
L3CS Initiative	<u>327,732</u>	<u> </u>	<u>327,732</u>
Total program expenses	17,794,199		17,794,199
Management and general	2,450,586		2,450,586
Fundraising	<u>26,512</u>	<u> </u>	<u>26,512</u>
Total expenses	<u>20,271,297</u>	<u> </u>	<u>20,271,297</u>
CHANGES IN NET ASSETS	(589,242)	1,694,534	1,105,292
Net assets, beginning of year	<u>1,665,152</u>	<u>1,170,037</u>	<u>2,835,189</u>
Net assets, end of year	<u>\$ 1,075,910</u>	<u>\$ 2,864,571</u>	<u>\$ 3,940,481</u>

See accompanying notes to consolidated financial statements.

Houston Advanced Research Center

Consolidated Statement of Activities for the year ended December 31, 2008

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>TOTAL</u>
REVENUE:			
Research contracts and grants (<i>Note 9</i>)	\$11,826,104		\$11,826,104
Contributions (<i>Note 12</i>)	1,508,880	\$ 245,000	1,753,880
Gain from sale of property and equipment	10,615		10,615
Other income	<u>30,088</u>	<u> </u>	<u>30,088</u>
Total revenue	13,375,687	245,000	13,620,687
Net assets released from restrictions:			
Satisfaction of program restrictions	<u>496,030</u>	<u>(496,030)</u>	<u> </u>
Total	<u>13,871,717</u>	<u>(251,030)</u>	<u>13,620,687</u>
EXPENSES:			
Program expenses:			
Environment	9,247,635		9,247,635
Energy and Building Solutions	2,293,388		2,293,388
L3CS Initiative	<u>297,213</u>		<u>297,213</u>
Total program expenses	11,838,236		11,838,236
Management and general	2,521,307		2,521,307
Fundraising	<u>10,750</u>		<u>10,750</u>
Total expenses	<u>14,370,293</u>		<u>14,370,293</u>
CHANGES IN NET ASSETS	(498,576)	(251,030)	(749,606)
Net assets, beginning of year	<u>2,163,728</u>	<u>1,421,067</u>	<u>3,584,795</u>
Net assets, end of year	<u>\$ 1,665,152</u>	<u>\$ 1,170,037</u>	<u>\$ 2,835,189</u>

See accompanying notes to consolidated financial statements.

Houston Advanced Research Center

Consolidated Statements of Cash Flows for the years ended December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Changes in net assets	\$ 1,105,292	\$ (749,606)
Adjustments to reconcile changes in net assets to net cash provided (used) by operating activities:		
Amortization of prepaid rent	225,303	224,942
Depreciation and amortization	246,291	303,218
Loss (gain) from sale of property and equipment	334,215	(10,615)
Changes in operating assets and liabilities:		
Accounts receivable	(1,106,233)	(702,422)
Pledges receivable	81,551	(34,880)
Other assets	(3,345)	(8,280)
Accounts payable	1,136,032	695,689
Accrued expenses	<u>(92,757)</u>	<u>(31,996)</u>
Net cash provided (used) by operating activities	<u>1,926,349</u>	<u>(313,950)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(56,445)	(263,385)
Proceeds from sale of property and equipment	<u>300,247</u>	<u>43,068</u>
Net cash provided (used) by investing activities	<u>243,802</u>	<u>(220,317)</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	2,170,151	(534,267)
Cash and cash equivalents, beginning of year	<u>246,424</u>	<u>780,691</u>
Cash and cash equivalents, end of year	<u>\$ 2,416,575</u>	<u>\$ 246,424</u>

See accompanying notes to consolidated financial statements.

Houston Advanced Research Center

Notes to Consolidated Financial Statements for the years ended December 31, 2009 and 2008

NOTE 1 – ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Organization – Houston Advanced Research Center (the Center), a Texas nonprofit corporation, is a university-affiliated organization focusing on research in human and ecosystem well-being. Major research interests are in the areas of the environment, energy, and policy analysis. The primary source of funding is research grants and contracts from both public and private sources. Philanthropic support provides funds for internal research and for expenditures not recovered from sponsored research activities.

HARC Technology, Inc. (HTI) is a wholly-owned subsidiary of the Center formed for the purpose of facilitating the transfer of promising technologies from the laboratory to the private sector.

Principles of consolidation – The consolidated financial statements include the accounts of the Center and HTI (collectively referred to as HARC). All significant intercompany balances and transactions are eliminated in consolidation.

Federal income tax status – The Center is exempt from federal income taxes under §501(c)(3) of the Internal Revenue Code and is classified as a public charity under §509(a)(2). HTI is a for-profit corporation subject to federal income taxes and has reported net operating losses for tax purposes since its inception. No deferred tax asset has been recorded because of the uncertainty regarding the ultimate realization of this benefit.

Cash equivalents include highly liquid investments with original maturities of three months or less.

Allowance for doubtful accounts – HARC provides an allowance for accounts receivable that it believes it may not collect in full. The amount of bad debt expense recorded each period and the resulting adequacy of the allowance at the end of each period are determined using a combination of historical loss experience and customer-by-customer analysis of accounts receivable balances.

Pledges receivable that are due within one year are recorded at net realizable value. Pledges receivable that are expected to be collected in future years are recorded at the present value of the expected future cash flows. Discounts are computed using risk-free interest rates applicable to the years in which the promises are received. Amortization of discounts is included in contribution revenue.

Property and equipment are recorded at cost, if purchased, or at fair value at the date of gift, if donated. Additions and improvements with a cost of more than \$5,000 are capitalized. Depreciation is calculated using the straight-line method over estimated useful lives of 3 to 5 years for furniture and equipment and 10 to 31.5 years for leasehold improvements.

Net asset classification – Contributions and the related net assets are classified based on the existence or absence of donor-imposed restrictions, as follows:

- *Unrestricted net assets* include those net assets whose use is not restricted by donor-imposed stipulations even though their use may be limited in other respects such as by contract or board designation.
- *Temporarily restricted net assets* include contributions restricted by the donor for specific purposes or time periods. When a purpose restriction is accomplished or a time restriction ends, temporarily restricted net assets are released to unrestricted net assets.

Research contracts and grants are recorded as revenue when the related services are provided.

Contributions are recorded as revenue at fair value when an unconditional commitment is received from the donor. Contributions received with donor stipulations that limit their use are recorded as restricted support. Conditional promises to give are included in contribution revenue when the conditions are substantially met.

Grants made are recognized as program expenses when substantially unconditional promises to give are made.

Estimates – Management must make estimates and assumptions to prepare financial statements in accordance with generally accepted accounting principles. These estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, the amounts reported as revenue and expenses, and the allocation of expenses among various functions. Actual results could vary from the estimates that were used.

NOTE 2 – CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of the following:

	<u>2009</u>	<u>2008</u>
Demand deposits	\$ 2,415,393	\$ 88,264
Money market mutual funds	<u>1,182</u>	<u>158,160</u>
Total cash and cash equivalents	<u>\$ 2,416,575</u>	<u>\$ 246,424</u>

Bank deposits exceed the federally insured limit per depositor per institution.

NOTE 3 – PLEDGES RECEIVABLE

Pledges receivable are as follows:

	<u>2009</u>	<u>2008</u>
Total pledges receivable	\$ 275,000	\$ 360,000
Discount to net present value at 1%	<u>(282)</u>	<u>(3,731)</u>
Pledges receivable, net	<u>\$ 274,718</u>	<u>\$ 356,269</u>

Pledges receivable at December 31, 2009 are due as follows:

2010	\$ 250,000
2011	<u>25,000</u>
Total pledges receivable	<u>\$ 275,000</u>

NOTE 4 – NOTE RECEIVABLE FROM TEXAS ENVIRONMENTAL RESEARCH CONSORTIUM

Note receivable represents an unsecured promissory note from Texas Environmental Research Consortium. The note is renewable until July 2012 with interest due within 30 days of each renewal period. The interest rate is the higher of the rate earned by HARC on its money market account or the rate HARC pays on outstanding balances on its line of credit.

NOTE 5 – PREPAID RENT

In 2002, HARC sold an office complex consisting of land and two buildings in exchange for cash and the future use of one of the buildings for a ten-year period. An amount equal to the difference between the appraised value of the complex and the cash proceeds from the sale is recognized as prepaid rent and is being amortized on a straight-line basis through 2012.

NOTE 6 – PROPERTY AND EQUIPMENT

Property and equipment consists of the following:

	<u>2009</u>	<u>2008</u>
Leasehold improvements	\$ 890,963	\$ 963,856
Furniture and equipment	<u>470,519</u>	<u>6,251,490</u>
Total property and equipment, at cost	1,361,482	7,215,346
Accumulated depreciation	<u>(861,670)</u>	<u>(5,891,226)</u>
Property and equipment, net	<u>\$ 499,812</u>	<u>\$ 1,324,120</u>

During 2009, HARC sold or transferred all the laboratory equipment to a university upon closure of the laboratory.

NOTE 7 – LINE OF CREDIT

HARC has a \$1,500,000 line of credit agreement with the Endowment for Regional Sustainability Science with interest at LIBOR plus .50%. The agreement expires December 31, 2013. There was no amount outstanding under the line at December 31, 2009.

NOTE 8 – TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets are available for the following purposes:

	<u>2009</u>	<u>2008</u>
Solar Energy Pilot Program	\$ 1,973,538	
Texas Climate Initiatives	294,544	\$ 543,465
Texas Fuels	146,937	
IFAS Implementation	103,575	298,311
Environmentally Friendly Drilling Project	76,896	
Universal Principles for a Sustainable Society	62,627	
Solar Project	53,155	50,000
Ecosystem and Biodiversity Measurement & Assessment Project	32,326	
Human Perception Influences the Sustainability of Communities	11,804	39,298
Internships	8,391	7,891
Collaboration Initiatives		201,072
Future operations	<u>100,778</u>	<u>30,000</u>
Total temporarily restricted net assets	<u>\$ 2,864,571</u>	<u>\$ 1,170,037</u>

NOTE 9 – RESEARCH CONTRACTS AND GRANTS

Revenue from research contracts and grants includes the following:

	<u>2009</u>	<u>2008</u>
Federal government contracts and grants:		
U.S. Department of Energy	\$ 1,420,807	\$ 567,425
U.S. Department of Homeland Security	286,139	832,477
U.S. Environmental Protection Agency	270,418	420,685
National Aeronautics and Space Administration	170,866	843,020
U.S. Geological Survey	140,634	83,743
U.S. Department of Commerce	86,185	140,775
U.S. Fish & Wildlife Service	48,867	4,129
National Science Foundation	456	17,349
U.S. Department of Agriculture		19,576
Other	<u>5,704</u>	<u>1,444</u>
Total federal government contracts and grants	<u>2,430,076</u>	<u>2,930,623</u>
State and local government contracts and grants:		
Texas Commission on Environmental Quality	13,705,393	8,351,967
Texas Water Development Board	<u>23,015</u>	<u> </u>
Total state and local government contracts and grants	<u>13,728,408</u>	<u>8,351,967</u>
Private research contracts and grants	<u>1,769,218</u>	<u>543,514</u>
Total research contracts and grants	<u>\$17,927,702</u>	<u>\$11,826,104</u>

NOTE 10 – RELATED PARTY TRANSACTIONS

HARC subcontracted research services with the employers of certain members of the HARC board of directors totaling approximately \$2,900,000 and \$1,500,000 during 2009 and 2008, respectively. These subcontractors were obtained through a competitive award process or based on their technical qualifications.

NOTE 11 – RETIREMENT PLAN

HARC has a tax sheltered annuity plan (the Plan) established under §403(b) of the Internal Revenue Code. Under the terms of the Plan, HARC contributes a minimum of five percent of the participating employees' regular monthly salaries. In addition, HARC will match one-half percent for each percent the employee contributes up to six percent, for a maximum HARC contribution of eight percent of regular salary. HARC contributed to the Plan approximately \$225,000 in 2009 and \$230,000 in 2008.

NOTE 12 – CONCENTRATIONS

During 2009, HARC received \$3,100,000 in contributions from two donors which represents 14% of total revenue. During 2008, HARC received \$1,500,000 in contributions from one donor which represents 11% of total revenue.

NOTE 13 – SUBSEQUENT EVENTS

In June 2010, HARC entered into a contract to buy a 3.5 acre tract of land for \$800,000.

Management has evaluated subsequent events through May 15, 2010, which is the date that the financial statements were available for issuance. As a result of this evaluation, no other events were identified that are required to be disclosed or would have a material impact on reported net assets or changes in net assets.

Houston Advanced Research Center

Schedule of Expenditures of Federal Awards for the year ended December 31, 2009

<u>GRANTOR</u> <u>Pass-through Grantor</u> <u>Program Title & Period</u>	<u>CFDA #</u>	<u>Contract Number</u> <u>or Pass-through</u> <u>Grantor Number</u>	<u>Award</u> <u>Amount</u>	<u>Revenue</u>	<u>Allowable</u> <u>Expenses</u>	
U.S. DEPARTMENT OF COMMERCE						
Passed through General Land Office, State of Texas:						
Texas Coastal Management Performance Measurements System						
#1	11/10/07 – 08/31/10	11.419	08-025-000	\$124,326	\$ 33,869	\$ 33,869
Passed through Gulf & South Atlantic Fisheries Foundation:						
Development of Social Indicators for Fishing Communities of the Southeast						
#2	06/01/08 – 11/30/09	11.427	103-01-77880/42300	\$77,880	27,408	27,408
Passed through Texas A&M University:						
Advancing Coastal Resilience						
#3	10/01/07 – 09/30/10	11.473	NA07NOS4730147	\$25,000	<u>24,908</u>	<u>24,908</u>
Total U.S. Department of Commerce				<u>86,185</u>	<u>86,185</u>	
U.S. FISH & WILDLIFE SERVICE						
Passed through Texas Parks & Wildlife Department:						
Freshwater Aquarium Hobbyists in the Houston-Galveston Region and Non-native Aquatic Species						
#4	08/18/08 – 08/31/11	15.634	198496	\$200,000	<u>48,867</u>	<u>48,867</u>
U.S. GEOLOGICAL SURVEY						
National Biological Information Infrastructure						
#5	08/01/09 – 06/30/10	15.808	G09PC00065	\$299,969	<u>140,634</u>	<u>132,941</u>
U.S. DEPARTMENT OF TRANSPORTATION						
Passed through Systems Research & Applications Corporation:						
Independent Verification and Validation for the Transportation Security Laboratory						
#6	09/08/08 – 06/15/09	20.106	S280000110	\$56,489	<u>5,704</u>	<u>5,581</u>
NATIONAL AERONAUTICS AND SPACE ADMINISTRATION						
Nano Energy Collaborative						
#7	10/01/06 – 09/30/09	43.002	NNJ06H124A	\$1,329,537	<u>170,866</u>	<u>170,866</u>

(continued)

Houston Advanced Research Center

Schedule of Expenditures of Federal Awards for the year ended December 31, 2009 *(continued)*

<u>GRANTOR</u>			Contract Number			
<u>Pass-through Grantor</u>			or Pass-through	Award		Allowable
<u>Program Title & Period</u>	<u>CFDA #</u>		<u>Grantor Number</u>	<u>Amount</u>	<u>Revenue</u>	<u>Expenses</u>
NATIONAL SCIENCE FOUNDATION						
Passed through Texas Agricultural Experiment Station:						
Land Trusts: Mediating Science and Policy on Conservation Lands						
#8	03/15/06 – 02/28/09	47.075	570318	\$80,199	456	456
U.S. ENVIRONMENTAL PROTECTION AGENCY						
Caterpillar 3500 Marine Retrofit - ARRA						
#9	08/01/09 – 10/31/10	66.039	2A-83441801-0	\$1,556,733	2,742	2,742
EPA Diesel Vehicle Emissions Reduction – ARRA						
#10	08/01/09 – 10/31/10	66.039	2A-83442001-0	\$2,000,000	28,340	28,340
Identifying and Evaluating Heat Island Reduction Opportunities						
#11	06/04/07 – 06/03/09	66.606	EP07H001697	\$65,300	6,790	6,790
Passed through University of Houston:						
Characterization of Eastern Texas Air Quality						
#12	05/01/07 – 04/30/10	66.001	R070160	\$320,216	58,922	58,922
Passed through Galveston Bay Estuary Program:						
Watershed Characterization Report for the						
East and West Forks of Double Bayou – ARRA						
#13	08/18/09 – 08/31/11	66.454	582-9-84999	\$348,322	23,859	23,859
Galveston Bay Estuary Program Freshwater Inflows						
#14	09/01/06 – 05/31/09	66.456	582-7-77804	\$15,000	3,966	3,966
Passed through Texas Commission on Environmental Quality:						
Field Guide to Invasive Species of Galveston Bay						
#15	06/20/08 – 05/31/10	66.456	582-8-84976	\$50,000	19,668	19,668
Characterization of the Galveston Bay Ecosystem, 3 rd Edition						
#16	07/24/08 – 08/31/09	66.475	582-8-84951	\$78,637	29,430	29,430
Characterization of the Galveston Bay Ecosystem, 3 rd Edition FY09						
#17	07/24/08 – 08/31/10	66.475	582-8-84951	\$137,919	53,588	53,588
Passed through Texas Environmental Research Consortium:						
Data Infrastructure for Linking Individual Emissions						
#18	05/01/07 – 04/30/10	66.500	R-07-0158	\$160,108	43,113	43,113
Total U.S. Environmental Protection Agency					270,418	270,418

(continued)

Houston Advanced Research Center

Schedule of Expenditures of Federal Awards for the year ended December 31, 2009 *(continued)*

<u>GRANTOR</u>			Contract Number			
<u>Pass-through Grantor</u>			or Pass-through	Award	Revenue	Allowable
<u>Program Title & Period</u>	<u>CFDA #</u>		<u>Grantor Number</u>	<u>Amount</u>		<u>Expenses</u>
U.S. DEPARTMENT OF ENERGY						
Battleground Energy Recovery Project						
#19	07/01/09 – 06/30/10	81.087	DE-EE0002028	\$748,895	189,223	189,223
Gulf Coast Clean Energy Application Center						
#20	10/01/09 – 09/30/10	81.087	DE-EE0001103	\$450,000	43,452	43,452
Hydrogen Education in Texas						
#21	08/01/08 – 08/31/10	81.087	DE-FG36-08GO18112	\$177,847	77,951	77,951
Passed through Texas A&M Research Foundation:						
New Technology for Future Colliders: Testing and Integration of AMS Superconducting Magnet at CERN						
#22	04/26/09 – 11/30/09	81.049	S090047	\$122,626	122,626	123,282
Passed through Texas H2 Coalition:						
Texas Hydrogen Highway						
#23	09/01/08 – 09/01/10	81.087		\$19,141	11,445	11,445
Passed through Research Partnership to Secure Energy for America:						
Deep Sea Hybrid Power Systems						
#24	10/31/08 – 05/31/10	81.089	07121-1902	\$480,000	310,996	310,996
Environmentally Friendly Drilling Systems						
#25	07/23/09 – 07/22/12	81.089	08122-35	\$2,199,895	358,856	358,856
Passed through Texas Environmental Experiment Station:						
Environmentally Friendly Drilling Systems						
#26	09/30/05 – 05/31/09	81.089	34322	\$255,180	30,012	30,012
Passed through City of Houston:						
Solar Houston Initiative						
#27	04/04/08 – 05/31/10	81.117	4600007403-2	\$183,100	88,583	70,493
Passed through State Energy Conservation Office:						
Regional CHP Application Center						
#28	01/01/06 – 12/31/09	81.117	CM612	\$685,500	<u>187,663</u>	<u>187,663</u>
Total U.S. Department of Energy					<u>1,420,807</u>	<u>1,403,373</u>

(continued)

Houston Advanced Research Center

Schedule of Expenditures of Federal Awards for the year ended December 31, 2009 (continued)

<u>GRANTOR</u>			<u>Contract Number</u>			
<u>Pass-through Grantor</u>			<u>or Pass-through</u>	<u>Award</u>		<u>Allowable</u>
<u>Program Title & Period</u>	<u>CFDA #</u>		<u>Grantor Number</u>	<u>Amount</u>	<u>Revenue</u>	<u>Expenses</u>
U.S. DEPARTMENT OF HOMELAND SECURITY						
Trace Explosives Threat Signature Characterization						
#29 09/15/06 – 06/15/09	97.069		06-G-018	\$1,709,837	<u>286,139</u>	<u>286,139</u>
TOTAL FEDERAL AWARDS					<u>\$ 2,430,076</u>	<u>\$ 2,404,826</u>

See accompanying note to schedules of expenditures of federal and state awards.

Houston Advanced Research Center

Schedule of Expenditures of State Awards for the year ended December 31, 2009

STATE GRANTOR

Pass-through Grantor

<u>Program Title & Period</u>	<u>Contract Number</u>	<u>Award Amount</u>	<u>Revenue</u>	<u>Allowable Expenses</u>
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TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Passed through Texas Environmental Research Consortium:

Air Quality Research Program FY08					
#S1	12/28/07 – 12/29/09	582-4-65587	\$3,460,447	\$ 1,676,705	\$ 1,676,705
Air Quality Research Program FY09					
#S2	09/01/08 – 12/29/09	582-4-65587	\$3,513,196	3,266,694	3,266,694
New Technology Research and Development Program FY07					
#S3	09/01/06 – 08/31/11	582-6-70848	\$7,310,363	4,587,904	4,587,904
New Technology Research and Development Program FY08					
#S4	09/01/07 – 08/31/11	582-6-70848	\$8,676,923	3,653,681	3,653,681
New Technology Research and Development Program FY09					
#S5	09/01/08 – 08/31/11	582-6-70848	\$8,692,462	427,419	427,419
TERC Back Office Assistance FY09					
#S6	09/01/08 – 12/29/09	582-4-65587/582-6-70848	\$88,669	66,426	66,426
TERC Website FY09					
#S7	09/01/08 – 12/29/09	582-4-65587/582-6-70848	\$27,500	<u>26,564</u>	<u>26,564</u>
Total Texas Commission on Environmental Quality				<u>13,705,393</u>	<u>13,705,393</u>

TEXAS WATER DEVELOPMENT BOARD

Bay Basin and Expert Science Team					
#S8	01/01/09 – 08/31/10	None	\$40,000	<u>23,015</u>	<u>23,015</u>

TOTAL STATE AWARDS			<u>\$13,728,408</u>	<u>\$13,728,408</u>
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See accompanying note to schedules of expenditures of federal and state awards.

Houston Advanced Research Center

Note to Schedules of Expenditures of Federal and State Awards for the year ended December 31, 2009

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation – The schedules of expenditures of federal and state awards are prepared on the accrual basis of accounting. The information in these schedules is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* for federal awards and the *Uniform Grant and Contract Management Standards* for state awards. Allowable expenses are determined in accordance with the standards of Office of Management and Budget Circular A-122, *Cost Principles for Non-Profit Organizations*, for federal awards and the *Uniform Grant and Contract Management Standards* for state awards.

Major programs – All of HARC's programs fall within the Research and Development cluster and, as such, are major programs.

**Report on Internal Control Over Financial Reporting and on
Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with Government Auditing Standards**

To the Board of Directors of
Houston Advanced Research Center:

We have audited the consolidated financial statements of Houston Advanced Research Center (HARC) as of and for the year ended December 31, 2009 and have issued our report thereon dated May 15, 2010. 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.

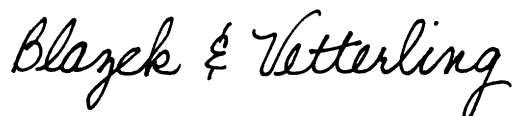
Internal Control Over Financial Reporting – In planning and performing our audit, we considered HARC’s internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of HARC’s internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of HARC’s internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, such that there is a reasonable possibility that a material misstatement of the financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters – As part of obtaining reasonable assurance about whether HARC’s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our audit tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, the board of directors, others within the entity, and federal and state awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



May 15, 2010

**Report on Compliance with Requirements Applicable to Each
Major Program and on Internal Control Over Compliance in
Accordance with OMB Circular A-133 and
the State of Texas Single Audit Circular**

To the Board of Directors of
Houston Advanced Research Center:

Compliance – We have audited the compliance of Houston Advanced Research Center (HARC) with the types of compliance requirements described in the OMB Circular A-133 *Compliance Supplement* that are applicable to each of its major federal and state programs for the year ended December 31, 2009. HARC's major federal and state programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal and state programs is the responsibility of HARC's management. Our responsibility is to express an opinion on HARC's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*; and in the *State of Texas Single Audit Circular*. Those standards and circulars require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on major federal and state programs occurred. An audit includes examining, on a test basis, evidence about HARC's compliance with those requirements and performing such other procedures, as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on HARC's compliance with those requirements.

In our opinion, HARC complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal and state programs for the year ended December 31, 2009.

Internal Control Over Compliance – The management of HARC is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal and state programs. In planning and performing our audit, we considered HARC's internal control over compliance with the requirements that could have a direct and material effect on major federal and state programs in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133 and the *State of Texas Single Audit Circular*, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of HARC's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal and state program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal and state program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses, and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. We did not identify any deficiencies in internal control over compliance that we consider to be a material weaknesses, as defined above.

This report is intended solely for the information and use of management, the board of directors, others within the entity, and federal and state awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Blazek & Vetterling

May 15, 2010

Houston Advanced Research Center

Schedule of Findings and Questioned Costs for the year ended December 31, 2009

Section I – Summary of Auditor’s Results

Financial Statements

Type of auditor’s report issued: unqualified qualified adverse disclaimer

Internal control over financial reporting:

- Material weakness(es) identified? yes no
- Significant deficiency(ies) identified that are not considered to be material weakness(es)? yes none reported

Noncompliance material to the financial statements noted? yes no

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? yes no
- Significant deficiency(ies) identified that are not considered to be material weakness(es)? yes none reported

Type of auditor’s report issued on compliance for major programs: unqualified qualified adverse disclaimer

Any audit findings disclosed that are required to be reported in accordance with §510(a) of Circular A-133? yes no

Identification of major programs:

CFDA Number(s) Name of Federal Program or Cluster

Various Research and Development

Identifying Number(s) Name of State Program or Cluster

Various Research and Development

Dollar threshold used to distinguish between Type A and Type B programs: \$300,000

Auditee qualified as a low-risk auditee? yes no

Section II – Financial Statement Findings

There were no findings for federal or state awards to be reported in accordance with *Government Auditing Standards*.

Section III – Federal Award Findings and Questioned Costs

There were no findings for federal awards required to be reported in accordance with §.510(a) of Circular A-133, and no findings for state awards required to be reported in accordance with §505(d) of the *State of Texas Single Audit Circular*.