

Houston Advanced Research Center

Consolidated Financial Statements
and Single Audit Reports
for the year ended December 31, 2010

Independent Auditors' Report

To the Board of Directors of
Houston Advanced Research Center:

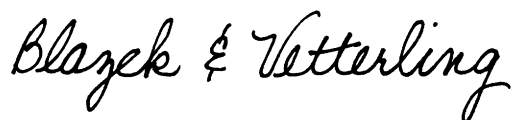
We have audited the accompanying consolidated statements of financial position of Houston Advanced Research Center as of December 31, 2010 and 2009 and the related consolidated statements of activities and of cash flows for the years then ended. These financial statements are the responsibility of the 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, 2010 and 2009 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 July 19, 2011, 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. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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, 2010 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, 2010 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 stated, in all material respects, in relation to the basic financial statements taken as a whole.



July 19, 2011

Houston Advanced Research Center

Consolidated Statements of Financial Position as of December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
ASSETS		
Cash	\$ 1,339,067	\$ 2,416,575
Accounts receivable, net of allowance for doubtful accounts of \$35,000 in 2010 and 2009	3,015,417	5,161,343
Pledges receivable	25,000	274,718
Other assets	87,812	21,701
Note receivable from Texas Environmental Research Consortium (Note 2)	300,000	300,000
Prepaid rent (Note 3)	335,625	559,375
Property and equipment, net (Note 4)	<u>1,183,813</u>	<u>499,812</u>
TOTAL ASSETS	<u>\$ 6,286,734</u>	<u>\$ 9,233,524</u>
LIABILITIES AND NET ASSETS		
Liabilities:		
Accounts payable	\$ 2,975,362	\$ 5,057,062
Accrued expenses	249,678	235,981
Deferred revenue	73,577	
Note payable (Note 5)	<u>820,000</u>	<u> </u>
Total liabilities	<u>4,118,617</u>	<u>5,293,043</u>
Net assets:		
Unrestricted	1,320,517	1,075,910
Temporarily restricted (Note 6)	<u>847,600</u>	<u>2,864,571</u>
Total net assets	<u>2,168,117</u>	<u>3,940,481</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 6,286,734</u>	<u>\$ 9,233,524</u>

See accompanying notes to consolidated financial statements.

Houston Advanced Research Center

Consolidated Statement of Activities for the year ended December 31, 2010

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>TOTAL</u>
REVENUE:			
Research contracts and grants <i>(Note 7)</i>	\$13,139,313		\$13,139,313
Contributions <i>(Notes 8 and 9)</i>	1,876,000	\$ 256,605	2,132,605
Other income	<u>100,812</u>	<u> </u>	<u>100,812</u>
Total revenue	15,116,125	256,605	15,372,730
Net assets released from restrictions:			
Satisfaction of program restrictions	2,172,798	(2,172,798)	
Expiration of time restriction	<u>100,778</u>	<u>(100,778)</u>	<u> </u>
Total	<u>17,389,701</u>	<u>(2,016,971)</u>	<u>15,372,730</u>
EXPENSES:			
Program expenses:			
Environment	8,980,573		8,980,573
Energy and Building Solutions	5,666,666		5,666,666
L3CS Initiative	<u>300,559</u>	<u> </u>	<u>300,559</u>
Total program expenses	14,947,798		14,947,798
Management and general	2,160,469		2,160,469
Fundraising	<u>36,827</u>	<u> </u>	<u>36,827</u>
Total expenses	<u>17,145,094</u>	<u> </u>	<u>17,145,094</u>
CHANGES IN NET ASSETS	244,607	(2,016,971)	(1,772,364)
Net assets, beginning of year	<u>1,075,910</u>	<u>2,864,571</u>	<u>3,940,481</u>
Net assets, end of year	<u>\$ 1,320,517</u>	<u>\$ 847,600</u>	<u>\$ 2,168,117</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 7)</i>	\$17,927,702		\$17,927,702
Contributions <i>(Notes 8 and 9)</i>	1,104,598	\$ 2,638,615	3,743,213
Loss from disposal of property and equipment <i>(Note 4)</i>	(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 Statements of Cash Flows for the years ended December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Changes in net assets	\$(1,772,364)	\$ 1,105,292
Adjustments to reconcile changes in net assets to net cash provided (used) by operating activities:		
Amortization of prepaid rent	223,750	225,303
Depreciation and amortization	188,456	246,291
Loss from disposal of property and equipment		334,215
Changes in operating assets and liabilities:		
Accounts receivable	2,145,926	(1,106,233)
Pledges receivable	249,718	81,551
Other assets	(66,111)	(3,345)
Accounts payable	(2,081,700)	1,136,032
Accrued expenses	13,697	(92,757)
Deferred revenue	<u>73,577</u>	<u> </u>
Net cash provided (used) by operating activities	<u>(1,025,051)</u>	<u>1,926,349</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(52,457)	(56,445)
Proceeds from sale of property and equipment	<u> </u>	<u>300,247</u>
Net cash provided (used) by investing activities	<u>(52,457)</u>	<u>243,802</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	(1,077,508)	2,170,151
Cash, beginning of year	<u>2,416,575</u>	<u>246,424</u>
Cash, end of year	<u>\$ 1,339,067</u>	<u>\$ 2,416,575</u>
<i>Supplemental disclosure of cash flow information:</i>		
Purchase of property and equipment with proceeds from note payable	\$820,000	
Interest paid	\$1,597	

See accompanying notes to consolidated financial statements.

Houston Advanced Research Center

Notes to Consolidated Financial Statements for the years ended December 31, 2010 and 2009

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.

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 recognized 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 reported at net realizable value. Pledges receivable that are expected to be collected in future years are reported 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. At December 31, 2010, all pledges receivable are expected to be collected within one year.

Property and equipment are reported 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 recognized as revenue when the related services are provided.

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

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 – 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 3 – 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 was recognized as prepaid rent and is being amortized on a straight-line basis through 2012.

NOTE 4 – PROPERTY AND EQUIPMENT

Property and equipment consists of the following:

	<u>2010</u>	<u>2009</u>
Land	\$ 829,376	
Leasehold improvements	890,963	\$ 890,963
Furniture and equipment	<u>513,600</u>	<u>470,519</u>
Total property and equipment, at cost	2,233,939	1,361,482
Accumulated depreciation	<u>(1,050,126)</u>	<u>(861,670)</u>
Property and equipment, net	<u>\$ 1,183,813</u>	<u>\$ 499,812</u>

During 2010, HARC acquired a 3.5 acre tract of land on which it plans to construct an office building. There were no outstanding commitments related to such plans at December 31, 2010.

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

NOTE 5 – NOTE PAYABLE

HARC has a \$1,500,000 unsecured line of credit agreement with the Endowment for Regional Sustainability Science with interest at LIBOR plus .50% (0.76% at December 31, 2010). Interest is payable quarterly and the unpaid principal is payable upon expiration date of the agreement on December 31, 2013.

NOTE 6 – TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets are available for the following purposes:

	<u>2010</u>	<u>2009</u>
Solar Energy Pilot Program	\$ 321,806	\$ 1,973,538
Texas Fuels	193,786	146,937
Texas Climate Initiatives	111,156	294,544
Industrial Energy Efficiency Outreach	94,920	
IFAS Implementation	79,008	103,575
Environmentally Friendly Drilling Project	26,794	76,896
Solar Project	11,739	53,155
Internships	8,391	8,391
Universal Principles for a Sustainable Society		62,627
Ecosystem and Biodiversity Measurement & Assessment Project		32,326
Human Perception Influences the Sustainability of Communities		11,804
Future operations		<u>100,778</u>
Total temporarily restricted net assets	<u>\$ 847,600</u>	<u>\$ 2,864,571</u>

NOTE 7 – RESEARCH CONTRACTS AND GRANTS

Revenue from research contracts and grants includes the following:

	<u>2010</u>	<u>2009</u>
Federal government contracts and grants:		
U.S. Environmental Protection Agency	\$ 3,822,109	\$ 270,418
U.S. Department of Energy	2,851,849	1,420,807
U.S. Geological Survey	248,931	140,634
U.S. Department of Commerce	78,015	86,185
U.S. Fish & Wildlife Service	70,752	48,867
U.S. Department of Homeland Security		286,139
National Aeronautics and Space Administration		170,866
National Science Foundation		456
Other	<u>500</u>	<u>5,704</u>
Total federal government contracts and grants	<u>7,072,156</u>	<u>2,430,076</u>
State and local government contracts and grants:		
Texas Commission on Environmental Quality	5,880,801	13,705,393
Texas Facilities Commission	20,000	
Texas Water Development Board	<u>2,238</u>	<u>23,015</u>
Total state and local government contracts and grants	<u>5,903,039</u>	<u>13,728,408</u>
Private research contracts and grants	<u>164,118</u>	<u>1,769,218</u>
Total research contracts and grants	<u>\$ 13,139,313</u>	<u>\$ 17,927,702</u>

NOTE 8 – CONCENTRATIONS

During 2010, HARC received \$1,876,000 in contributions from one donor which represents 12% of total revenue. During 2009, HARC received \$3,100,000 in contributions from two donors which represents 14% of total revenue.

NOTE 9 – CONDITIONAL CONTRIBUTIONS

In 2007, the Endowment for Regional Sustainability Science made a conditional contribution of \$1,512,000 to HARC. As of December 31, 2010, \$1,332,000 has been recognized as contribution revenue. The contribution is conditioned upon continued employment of the President at HARC.

NOTE 10 – RELATED PARTY TRANSACTIONS

HARC subcontracted research services with the employers of certain members of the HARC board of directors totaling approximately \$1,000,000 and \$2,900,000 during 2010 and 2009, 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 \$219,000 in 2010 and \$225,000 in 2009.

NOTE 12 – SUBSEQUENT EVENTS

Management has evaluated subsequent events through July 19, 2011, 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, 2010

<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>
U.S. DEPARTMENT OF COMMERCE							
Passed through General Land Office, State of Texas:							
Texas Coastal Management Performance Measurements System							
#1	11/10/07 – 09/30/10	11.419	08-025-000	\$124,326	\$ 26,614	\$ 26,614	
Passed through Gulf & South Atlantic Fisheries Foundation:							
Conducting Drop-off-pick-up Survey to Assess Well-being in Fishing Communities							
#2	08/01/10 – 07/31/11	11.433	112-01-38901/0	\$38,901	31,703	31,703	
The Role of Shrimp Imports in the Decline of Shrimp Reliant Communities in the Gulf of Mexico							
#3	08/01/10 – 07/31/11	11.454	114-01-82772	\$82,772	19,698	19,698	
Total U.S. Department of Commerce					78,015	78,015	
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	11/10/08 – 08/31/11	15.634	198496	\$200,000	70,752	70,752	
U.S. GEOLOGICAL SURVEY							
National Biological Information Infrastructure							
#5	08/01/09 – 06/30/10	15.808	G09PC00065	\$299,969	159,334	158,812	
#6	08/01/10 – 06/30/11	15.808	G09PC00065	\$255,000	89,597	89,597	
Total U.S. Geological Survey					248,931	248,409	
U.S. ENVIRONMENTAL PROTECTION AGENCY							
Caterpillar 3500 Marine Retrofit – ARRA							
#7	08/01/09 – 03/31/11	66.039	2A-83441801-0	\$1,556,733	1,507,426	1,507,426	
EPA Diesel Vehicle Emissions Reduction – ARRA							
#8	08/01/09 – 10/31/11	66.039	2A-83442001-0	\$2,362,843	1,492,625	1,492,625	
Simultaneous Emissions Reduction and Fuel Savings							
#9	04/01/10 – 03/31/12	66.039	DE-00F11301-1	\$811,934	390,222	390,222	

(continued)

Houston Advanced Research Center

Schedule of Expenditures of Federal Awards for the year ended December 31, 2010 *(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>
Passed through University of Houston:						
Characterization of Eastern Texas Air Quality						
#10	05/01/07 – 04/30/11	66.001	R070160	\$320,216	119,228	119,228
Passed through City of Houston:						
Houston Climate Showcase						
#11	01/25/10 – 09/27/12	66.041	4600007403	\$187,000	89,838	89,838
Passed through Galveston Bay Estuary Program:						
Watershed Characterization Report for the						
East and West Forks of Double Bayou – ARRA						
#12	08/18/09 – 08/31/11	66.454	582-9-84999	\$348,322	45,281	45,281
Passed through Texas Commission on Environmental Quality:						
Field Guide to Invasive Species of Galveston Bay						
#13	06/20/08 – 08/31/10	66.456	582-8-84976	\$61,000	31,037	31,037
Characterization of the Galveston Bay Ecosystem, 3 rd Edition FY09						
#14	07/24/08 – 08/31/11	66.475	582-8-84951	\$137,919	60,980	60,980
Characterization of the Galveston Bay Ecosystem, 3 rd Edition FY10						
#15	08/23/10 – 08/31/11	66.475	582-8-84951	\$93,882	40,828	40,828
Passed through Texas Environmental Research Consortium:						
Data Infrastructure for Linking Individual Emissions						
#16	05/01/07 – 04/30/10	66.500	R-07-0158	\$160,108	44,644	44,644
Total U.S. Environmental Protection Agency					<u>3,822,109</u>	<u>3,822,109</u>
U.S. DEPARTMENT OF ENERGY						
Gulf Coast Clean Energy Application Center						
#17	10/01/09 – 10/31/11	81.087	DE-EE0001103	\$864,156	736,160	736,160
Battleground Energy Recovery Project						
#18	07/01/09 – 06/30/11	81.087	DE-EE0002028	\$748,895	434,579	434,579
Hydrogen Education in Texas						
#19	08/01/08 – 02/28/11	81.087	DE-FG36-08GO18112	\$177,847	52,306	52,306
Passed through Texas H2 Coalition:						
Texas Hydrogen Highway						
#20	09/01/08 – 02/28/11	81.087		\$19,141	7,461	7,461

(continued)

Houston Advanced Research Center

Schedule of Expenditures of Federal Awards for the year ended December 31, 2010 *(continued)*

<u>GRANTOR</u>			Contract Number	Award		Allowable
<u>Pass-through Grantor</u>			or Pass-through	Amount	Revenue	Expenses
<u>Program Title & Period</u>	<u>CFDA #</u>		<u>Grantor Number</u>			
Passed through Pasadena Independent School District:						
Solar School						
#21	09/14/10 – 08/31/11	81.041	CM1106/CM1107	\$205,000	8,712	8,712
Passed through Research Partnership to Secure Energy for America:						
Deep Sea Hybrid Power Systems						
#22	10/31/08 – 10/31/10	81.089	07121-1902	\$480,000	147,918	147,918
Environmentally Friendly Drilling Systems						
#23	07/23/09 – 07/22/12	81.089	08122-35	\$2,199,895	838,960	838,960
Passed through City of Houston:						
Solar Generator Program – ARRA						
#24	04/28/10 – 12/31/11	81.041	4600007403	\$77,525	24,152	23,499
Solar Houston Initiative						
#25	06/01/08 – 06/30/11	81.117	4600007403-2	\$183,100	45,444	50,148
Third-Party Construction Document Review – ARRA						
#26	06/09/09 – 11/06/09	81.128	4600007403 WA#4	\$11,550	11,550	11,550
Third-Party Review and Analysis – ARRA						
#27	07/12/10 – 08/31/10	81.128	4600007403 WA#18	\$102,951	102,943	97,239
Energy Efficiency and Conservation Block Grant – ARRA						
#28	01/27/10 – 09/27/12	81.128	4600007403 WA#2	\$453,182	78,670	77,544
#29	03/05/10 – 06/23/10	81.128	4600007403 WA#3A	\$27,713	26,068	25,250
#30	03/05/10 – 06/23/10	81.128	4600007403 WA#3B	\$184,006	184,006	181,566
#31	03/05/10 – 06/23/10	81.128	4600007403 WA#3C	\$54,002	51,228	49,840
#32	05/10/10 – 09/27/12	81.128	4600007403 WA#5	\$197,890	36,240	34,920
#33	03/17/09 – 05/31/10	81.128	4600007403 WA#6	\$35,000	3,000	3,000
#34	01/01/10 – 09/27/12	81.128	4600007403 WA#6	\$125,000	<u>62,452</u>	<u>55,674</u>
Total U.S. Department of Energy					<u>2,851,849</u>	<u>2,836,326</u>
U.S. DEPARTMENT OF THE INTERIOR						
Passed through National Oceanic and Atmospheric Administration:						
Gulf of Mexico Fishery Management Council's Ecosystem						
SSC Advisory Committee						
#35	12/01/09 – 12/31/11	None		\$1,152	<u>500</u>	<u>500</u>
TOTAL FEDERAL AWARDS					<u>\$ 7,072,156</u>	<u>\$ 7,056,111</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, 2010

STATE GRANTOR

Pass-through Grantor

Program Title & Period

Contract Number

Award
Amount

Revenue

Allowable
Expenses

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Passed through Texas Environmental Research Consortium:

New Technology Research and Development Program FY08

#S1	09/01/07 – 08/31/10	582-6-70848	\$8,699,314	\$ 2,278,130	\$ 2,278,130
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New Technology Research and Development Program FY09

#S2	09/01/08 – 08/31/11	582-6-70848	\$8,693,951	3,527,986	3,527,986
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Passed through Mickey Leland National Urban Air Toxics Research Center:

Air Pollution and Exposure Research Information Infrastructure

#S3	02/08/10 – 11/30/10	None	\$74,998	<u>74,685</u>	<u>74,685</u>
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Total Texas Commission on Environmental Quality

5,880,801 5,880,801

TEXAS WATER DEVELOPMENT BOARD

Texas Water Development Board Advisory Committee

#S4	10/01/10 – 06/30/11	None	\$15,000	<u>2,238</u>	<u>2,238</u>
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TEXAS FACILITIES COMMISSION

Combined Heat and Power Feasibility Assessment

#S5	04/06/10 – 08/31/11	10-115-000 IAC	\$20,000	<u>20,000</u>	<u>20,000</u>
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TOTAL STATE AWARDS

\$ 5,903,039 \$ 5,903,039

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, 2010

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 OMB Circular A-122, *Cost Principles for Non-Profit Organizations*, for federal awards and the *Uniform Grant and Contract Management Standards* for state awards, and are expensed in the statement of activities in conformity with generally accepted accounting principles.

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, 2010 and have issued our report thereon dated July 19, 2011. 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, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s 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 was not designed to identify all deficiencies in internal control over financial reporting 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.

Blazek & Vetterling

July 19, 2011

**Report on Compliance with Requirements That Could Have a Direct
and Material Effect on 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 could have a direct and material effect on each of its major federal and state programs for the year ended December 31, 2010. HARC's major federal and state programs are identified in the summary of auditor's 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 could have a direct and material effect on each of its major federal and state programs for the year ended December 31, 2010.

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 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 first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be 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, 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

July 19, 2011

Houston Advanced Research Center

Schedule of Findings and Questioned Costs for the year ended December 31, 2010

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 and State 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 related to the financial statements which are required to be reported in accordance with *Government Auditing Standards*.

Section III – Federal and State Award Findings and Questioned Costs

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