Houston Advanced Research Center

Consolidated Financial Statements
and Single Audit Reports
for the year ended December 31, 2018

Houston Advanced Research Center

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Blazek & Vetterling
CERTIFIED PUBLIC ACCOUNTANTS

Independent Auditors' Report

To the Board of Directors of
Houston Advanced Research Center:

Report on the Financial Statements

We have audited the accompanying financial statements of Houston Advanced Research Center, which comprise the consolidated statements of financial position as of December 31, 2018 and 2017 and the related consolidated statements of activities and of cash flows for the years then ended, the related consolidated statement of functional expenses for the year ended December 31, 2018, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Houston Advanced Research Center as of December 31, 2018 and 2017 and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Adoption of New Accounting Standard

As discussed in Note 2 to the financial statements, Houston Advanced Research Center adopted the amendments of Accounting Standards Update (ASU) 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities,* as of and for the year ended December 31, 2018. These amendments have been applied on a retrospective basis to the financial statements as of and for the year ended December 31, 2017, except that certain information has been omitted as permitted by the ASU. Our opinion is not modified with respect to this matter.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying supplementary information included in the schedule of expenditures of federal awards for the year ended December 31, 2018 as required by Title 2 U. S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Report Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated July 26, 2019 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, and grant agreements and other matters. The purpose of that report is solely 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 effectiveness of Houston Advanced Research Center's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Houston Advanced Research Center's internal control over financial reporting and compliance.

Blazek & Vetterling

July 26, 2019

Houston Advanced Research Center

Consolidated Statements of Financial Position as of December 31, 2018 and 2017

	2018	2017
ASSETS		
Cash	$ 155,496	$ 135,297
Accounts receivable	267,214	215,895
Prepaid expenses and other assets	46,983	50,655
Contributions receivable	271,620	81,600
Property and equipment, net *(Note 4)*	7,668,306	7,895,351
TOTAL ASSETS	$ 8,409,619	$ 8,378,798
LIABILITIES AND NET ASSETS		
Liabilities:		
Accounts payable	$ 171,257	$ 308,546
Accrued expenses	129,658	142,805
Deferred revenue		32,573
Note payable *(Note 5)*	4,079,010	4,272,247
Total liabilities	4,379,925	4,756,171
Net assets:		
Without donor restrictions	3,368,461	3,402,755
With donor restrictions *(Note 6)*	661,233	219,872
Total net assets	4,029,694	3,622,627
TOTAL LIABILITIES AND NET ASSETS	$ 8,409,619	$ 8,378,798

See accompanying notes to consolidated financial statements.

Houston Advanced Research Center

Consolidated Statement of Activities for the year ended December 31, 2018

	WITHOUT DONOR RESTRICTIONS	WITH DONOR RESTRICTIONS	TOTAL
REVENUE:			
Research contracts and grants *(Note 7)*	$ 1,315,021		$ 1,315,021
Contributions	2,579,447	$ 906,000	3,485,447
Other income	4,611		4,611
Total revenue	3,899,079	906,000	4,805,079
Net assets released from restrictions:			
Satisfaction of program restrictions	464,639	(464,639)	
Total	4,363,718	441,361	4,805,079
EXPENSES:			
Program expenses:			
Energy and Building Solutions	1,522,245		1,522,245
Environment	901,801		901,801
Total program expenses	2,424,046		2,424,046
Management and general	1,959,127		1,959,127
Fundraising	14,839		14,839
Total expenses	4,398,012		4,398,012
CHANGES IN NET ASSETS	(34,294)	441,361	407,067
Net assets, beginning of year	3,402,755	219,872	3,622,627
Net assets, end of year	$ 3,368,461	$ 661,233	$ 4,029,694

See accompanying notes to consolidated financial statements.

Houston Advanced Research Center

Consolidated Statement of Activities for the year ended December 31, 2017

	WITHOUT DONOR RESTRICTIONS	WITH DONOR RESTRICTIONS	TOTAL
REVENUE:			
Research contracts and grants *(Note 7)*	$ 1,574,193		$ 1,574,193
Contributions	3,238,456	$ 232,251	3,470,707
Other income	10,899		10,899
Total revenue	4,823,548	232,251	5,055,799
Net assets released from restrictions:			
Capital expenditure releases	2,988,072	(2,988,072)	
Satisfaction of program restrictions	352,373	(352,373)	
Total	8,163,993	(3,108,194)	5,055,799
EXPENSES:			
Program expenses:			
Energy and Building Solutions	1,703,549		1,703,549
Environment	1,006,468		1,006,468
Total program expenses	2,710,017		2,710,017
Management and general	2,250,261		2,250,261
Total expenses	4,960,278		4,960,278
CHANGES IN NET ASSETS	3,203,715	(3,108,194)	95,521
Net assets, beginning of year	199,040	3,328,066	3,527,106
Net assets, end of year	$ 3,402,755	$ 219,872	$ 3,622,627

See accompanying notes to consolidated financial statements.

Houston Advanced Research Center

Consolidated Statement of Functional Expenses for the year ended December 31, 2018

	PROGRAM EXPENSES	MANAGEMENT AND GENERAL	FUNDRAISING	TOTAL EXPENSES
Payroll and related benefits	$ 1,514,044	$ 1,310,179	$ 11,559	$ 2,835,782
Depreciation	147,882	215,163		363,045
Subcontracts	357,895			357,895
Consulting and professional fees	86,400	102,574	2,880	191,854
Interest expense	52,780	90,945		143,725
Occupancy	87,990	22,653		110,643
Information technology	35,668	56,171		91,839
Travel	46,245	29,338		75,583
Conferences, meetings, and events	31,241	41,335		72,576
Office supplies	20,010	49,350	400	69,760
Insurance	29,029	32,098		61,127
Other	14,862	9,321		24,183
Total expenses	$ 2,424,046	$ 1,959,127	$ 14,839	$ 4,398,012

See accompanying notes to consolidated financial statements.

Houston Advanced Research Center

Consolidated Statements of Cash Flows for the years ended December 31, 2018 and 2017

	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Changes in net assets	$ 407,067	$ 95,521
Adjustments to reconcile changes in net assets to net cash provided by operating activities:		
Contributions restricted for capital campaign projects		(12,251)
Depreciation	363,045	305,891
Changes in operating assets and liabilities:		
Accounts receivable	(51,319)	891,780
Prepaid expenses and other assets	3,672	50,318
Contributions receivable	(190,020)	(81,600)
Accounts payable	(137,289)	(484,135)
Accrued expenses	(13,147)	21,485
Deferred revenue	(32,573)	29,248
Net cash provided by operating activities	349,436	816,257
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(122,987)	(36,978)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from contributions restricted for capital campaign projects		12,251
Repayment of note payable	(206,250)	(817,556)
Net cash used by financing activities	(206,250)	(805,305)
NET CHANGE IN CASH	20,199	(26,026)
Cash, beginning of year	135,297	161,323
Cash, end of year	$ 155,496	$ 135,297

Supplemental disclosure of cash flow information:		
Purchases of property and equipment funded by note payable	$13,013	$2,702,499
Interest paid	$143,725	$91,551

See accompanying notes to consolidated financial statements.

NOTE 1 – ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Organization – Houston Advanced Research Center (the Center), a Texas nonprofit corporation, is a research hub providing independent analysis on energy, air and water issues to people seeking scientific answers. 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.

Basis of consolidation – These consolidated financial statements include the assets, liabilities, net assets and activities of the Center and HTI (collectively HARC). All significant intercompany balances and transactions have been eliminated in consolidation.

Federal income tax status – The Center is exempt from federal income tax under §501(c)(3) of the Internal Revenue Code and is classified as a public charity under §509(a)(2).

Contributions receivable that are expected to be collected within one year are reported at net realizable value. Amounts expected to be collected in more than one year are discounted to estimate the present value of future cash flows, if material. At December 31, 2018, all contributions receivable are expected to be collected within one year.

Property and equipment is 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 provided using the straight-line method over estimated useful lives of 3 to 5 years for furniture and equipment and 10 to 31 ½ years for building and improvements.

Net asset classification – Net assets, revenue, gains, and losses are classified based on the existence or absence of donor-imposed restrictions, as follows:

- *Net assets without donor restrictions* are not subject to donor-imposed restrictions even though their use may be limited in other respects such as by contract or board designation.
- *Net assets with donor restrictions* are subject to donor-imposed restrictions. Restrictions may be temporary in nature, such as those that will be met by the passage of time or use for a purpose specified by the donor, or may be perpetual in nature, where the donor stipulates that resources be maintained in perpetuity. Net assets are released from restrictions when the stipulated time has elapsed, or purpose has been fulfilled, or both. Contributions of long-lived assets and of assets restricted for acquisition of long-lived assets are released when those assets are placed in service.

Research contracts and grants are recognized as revenue when the related services are provided. Amounts received in advance are reported as deferred revenue.

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 contributions are recognized in the same manner when the conditions are substantially met. During 2018, HARC received $2,550,000 in contributions from one donor, which represents 53% of total revenue. During 2017, HARC received $3,217,758 in contributions from one donor, which represents 64% of total revenue.

Functional allocation of expenses – Expenses are reported by their functional classification as program services or supporting activities. Program services are the direct conduct or supervision of activities that fulfill the purposes for which the organization exists. Fundraising activities include the solicitation of contributions of money, securities, materials, facilities, other assets, and time. Management and general activities are not directly identifiable with specific program or fundraising activities. Expenses that are attributable to one or more programs or supporting activities are allocated among the activities benefitted. Salaries and related costs are allocated on the basis of estimated time and effort expended. Depreciation and interest expenses are allocated based on square footage.

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.

Recent financial accounting pronouncements – In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers*, which replaces most existing revenue recognition guidance for exchange transactions not specifically covered by other guidance. This ASU does not apply to non-exchange transactions such as contributions. The core principle of the new guidance is that an entity should recognize revenue in an amount that reflects the consideration to which it expects to be entitled in exchange for transferred goods or services and establishes a 5-step process to determine when performance obligations are satisfied and revenue is recognized. The ASU is effective for fiscal year 2019 and must be applied retrospectively. HARC is required to adopt this ASU in fiscal year 2019. Management has not yet determined the impact adoption of this ASU will have on the financial statements.

In June 2018, the FASB issued ASU 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. The amendments in this ASU clarify and improve current guidance about whether a transfer of assets (or the reduction, settlement, or cancellation of liabilities) is a contribution or an exchange transaction and provide additional guidance on determining whether a contribution is conditional or unconditional. This ASU could impact the timing of revenue recognition and the financial statement disclosures related to such transactions. HARC is required to adopt this ASU in fiscal year 2019. The amendments should be applied on a modified prospective basis, but retrospective application also is permitted. Management has not determined the eventual method of adoption of the ASU or the impact on the financial statements.

NOTE 2 – ADOPTION OF ACCOUNTING STANDARDS UPDATE 2016-14

HARC adopted the amendments of ASU 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities,* as of and for the year ended December 31, 2018. These amendments have been applied on a retrospective basis to the financial statements for the year ended December 31, 2017, except that information regarding liquidity and availability of resources has been omitted as permitted by the ASU. Adoption of this ASU resulted in reclassification of previously reported activities and net assets to conform to the 2018 presentation but had no impact on total net assets or total changes in net assets for 2017.

NOTE 3 – LIQUIDITY AND AVAILABILITY OF RESOURCES

Financial assets available for general expenditure, that is, without donor or other restrictions limiting their use within one year of December 31, 2018 comprise the following:

Financial assets at December 31, 2018:	
Cash	$ 155,496
Accounts receivable	267,214
Contributions receivable	271,620
Total financial assets	694,330
Less financial assets not available for general expenditure:	
Donor-restricted assets subject to satisfaction of restriction	(152,729)
Total financial assets available for general expenditure	$ 541,601

For purposes of analyzing resources available to meet general expenditures over a 12-month period, HARC considers all expenditures related to its ongoing activities of Energy and Building Solutions and Environment programs, as well as the conduct of services undertaken to support these activities, to be general expenditures.

HARC regularly monitors liquidity in order to meet its operating needs and contractual commitments, while striving to minimize use of the annual unrestricted contribution received from an endowment fund with a similar mission. HARC's annual budget is based on expected general expenditures for the next 12-month period and management anticipates collecting sufficient revenue to fund general expenditures not funded by restricted resources.

NOTE 4 – PROPERTY AND EQUIPMENT

Property and equipment consists of the following:

	2018	2017
Land	$ 829,376	$ 829,376
Building and improvements	7,065,560	6,929,560
Furniture and equipment	986,647	986,647
Total property and equipment, at cost	8,881,583	8,745,583
Accumulated depreciation	(1,213,277)	(850,232)
Property and equipment, net	$ 7,668,306	$ 7,895,351

NOTE 5 – NOTE PAYABLE

Note payable consists of the following:

	2018	2017
A $4,500,000 line of credit with a bank maturing in September 2020 for the construction of a building. The line bears an interest rate of LIBOR plus 1.4% (3.88% at December 31, 2018). The line of credit is secured by the building. Accrued interest is due monthly.	$ 4,079,010	$ 4,272,247
Total note payable	$ 4,079,010	$ 4,272,247

The note payable is due as follows:

2019	$ 225,000
2020	3,854,010
Total	$ 4,079,010

HARC capitalized interest totaling approximately $12,000 in 2017. Interest expense totaled approximately $144,000 and $79,000 in 2018 and 2017, respectively.

HARC had a $1,500,000 unsecured line of credit with the Endowment for Regional Sustainability Science with interest at LIBOR plus 0.50%. The line expired on December 31, 2018.

NOTE 6 – NET ASSETS WITH DONOR RESTRICTIONS

Net assets with donor restrictions are restricted as follows:

	2018	2017
Subject to expenditure for specified purpose:		
Development of Galveston Bay Report Card	$ 295,202	$ 18,780
City of Houston Climate Action Plan	254,378	
Astrophysics Research	68,742	106,310
One Solution upgrades	41,468	41,468
Energy Efficiency and Resiliency program	1,443	1,880
Water Challenge Pilot program		51,434
Total net assets with donor restrictions	$ 661,233	$ 219,872

NOTE 7 – RESEARCH CONTRACTS AND GRANTS

Revenue from research contracts and grants includes the following:

	2018	2017
Federal government contracts and grants:		
U. S. Department of Energy	$ 802,591	$ 822,194
U. S. Environmental Protection Agency	162,779	37,272
U. S. Department of the Interior		50,544
U. S. Department of Commerce		40,356
Total federal government contracts and grants	965,370	950,366
State and local government contracts and grants	28,531	78,773
Private research contracts and grants	321,120	545,054
Total research contracts and grants	$ 1,315,021	$ 1,574,193

HARC receives grants from federal, state and local government funding sources that require fulfillment of certain conditions as set forth in the related contracts and are subject to review and audit by the awarding agencies. Such reviews and audits could result in the discovery of unallowable activities and unallowable costs. Consequently, any of the funding sources may, at their discretion, request reimbursement for expenses or return of funds as a result of non-compliance by HARC with the terms of the contracts. Management believes such disallowances, if any, would not be material to HARC's financial position or changes in net assets.

NOTE 8 – 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 5% of the participating employees' regular monthly salaries. In addition, HARC will match 1/2% for each percent the employee contributes up to 6%, for a maximum HARC contribution of 8% of regular salary. HARC contributed to the Plan approximately $150,000 in 2018 and $164,000 in 2017.

NOTE 9 – SUBSEQUENT EVENTS

Management has evaluated subsequent events through July 26, 2019, which is the date that the financial statements were available for issuance. As a result of this evaluation, no 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, 2018

CLUSTER TITLE GRANTOR Pass-through Grantor Program Title & Period		CFDA #	Contract Number or Pass-through Grantor Number	Award Amount	Federal Expenditures
RESEARCH AND DEVELOPMENT CLUSTER					
U. S. DEPARTMENT OF ENERGY					
Passed through State Energy Conservation Office:					
	State Energy Program – Cities Energy Efficiency 2018				
#1	01/23/18 – 08/31/19	81.041	0776	$285,000	$ 174,185
	State Energy Program – Speer SECO Grant Part 3				
#2	11/05/18 – 08/31/19	81.041	6767JM	$150,000	18,360
	Subtotal for 81.041				192,545
	Fossil Energy Research and Development – Flaring Technologies				
#3	10/01/18 – 09/30/19	81.089	DE-FE0031691	$138,179	29,848
Passed through GSI Environmental, Inc.:					
	Fossil Energy Research and Development – Greenhouse Gases Emissions Factors for Compressors				
#4	10/17/16 – 07/31/18	81.089	SC4501-001	$50,000	18,508
	Fossil Energy Research and Development – Natural Gas Storage Emissions				
#5	10/17/16 – 09/30/18	81.089	SC4502-001	$40,000	6,549
	Subtotal for 81.089				54,905
	Energy Efficiency and Renewable Energy Information Dissemination, Outreach, Training and Technical Analysis/Assistance – Southwest/Upper West Combined Heat and Power Technical Assistance Partnerships				
#6	08/01/18 – 09/30/19	81.117	DE-EE0008272	$1,643,422	552,257
	Energy Efficiency and Renewable Energy Information Dissemination, Outreach, Training and Technical Analysis/Assistance – Southwest Combined Heat and Power Technical Assistance Partnerships				
#7	10/01/15 – 03/31/18	81.117	DE-EE0007233	$1,139,367	2,884
	Subtotal for 81.117				555,141
Total U. S. Department of Energy					802,591

(continued)

CLUSTER TITLE GRANTOR Pass-through Grantor Program Title & Period		CFDA #	Contract Number or Pass-through Grantor Number	Award Amount	Federal Expenditures
RESEARCH AND DEVELOPMENT CLUSTER *(continued)*					
U. S. ENVIRONMENTAL PROTECTION AGENCY					
Passed through Texas Commission on Environmental Quality:					
	Galveston Bay Estuary Program – Assessing the Assimilative Capacity of Lake Livingston Reservoir and Related Impacts on Coastal Inflows				
#8	09/01/15 – 05/31/19	66.416	582-16-60126	$160,000	82,624
	National Estuary Program – A Characterization of the Galveston Bay Ecosystem Fourth Edition				
#9	09/01/17 – 08/31/19	66.456	582-18-80343	$85,000	68,706
	National Estuary Program – Estuary Resilience Assessment				
#10	09/01/18 – 05/31/20	66.456	582-19-90217	$30,000	2,931
	Subtotal for 66.456				71,637
Passed through Texas State Soil and Water Conservation Board:					
	Nonpoint Source Implementation Grants – Double Bayou Watershed Protection Planning Implement				
#11	09/01/18 – 08/31/21	66.460	18-07	$363,196	8,518
Total U. S. Environmental Protection Agency					162,779
TOTAL FEDERAL AWARDS/RESEARCH AND DEVELOPMENT CLUSTER					$ 965,370

See accompanying note to schedule of expenditures of federal awards.

Houston Advanced Research Center

Note to Schedule of Expenditures of Federal Awards for the year ended December 31, 2018

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation – The schedule of expenditures of federal awards is prepared on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of Title 2 U. S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Federal expenditures include allowable costs funded by federal grants. Allowable costs are subject to the cost principles of the Uniform Guidance and include both costs that are capitalized and costs that are recognized as expenses in HARC's financial statements in conformity with generally accepted accounting principles. Indirect costs are reported utilizing HARC's approved indirect cost rate from the United States Department of Interior. HARC does not utilize the 10% de minimus indirect rate.

Because the schedule presents only a selected portion of the operations of HARC, it is not intended to and does not present the financial position, changes in net assets, or cash flows of HARC.

Major programs – All of HARC's programs fall within the Research and Development cluster, which as a result, is the major program.

Blazek & Vetterling

CERTIFIED PUBLIC ACCOUNTANTS

Independent Auditors' 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, in accordance with the 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, the financial statements of Houston Advanced Research Center (HARC), which comprise the consolidated statement of financial position as of December 31, 2018 and the related consolidated statements of activities, of functional expenses, and of cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated July 26, 2019.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered HARC's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of HARC's internal control.

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 a 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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether HARC's financial statements are free from 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

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results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of HARC's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Blazek & Vetterling

July 26, 2019

Independent Auditors' Report on Compliance for Each Major Program and Report on Internal Control Over Compliance Required by the Uniform Guidance

To the Board of Directors of
Houston Advanced Research Center:

Report on Compliance for Each Major Federal Program

We have audited Houston Advanced Research Center's (HARC) compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on HARC's major federal program for the year ended December 31, 2018. HARC's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal program.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for HARC's major federal program based on our audit of the types of compliance requirements referred to above. 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 the audit requirements of Title 2 U. S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance 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 a major federal program 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 on compliance for the major federal program. However, our audit does not provide a legal determination of HARC's compliance.

Opinion on Each Major Federal Program

In our opinion, HARC complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2018.

Report on Internal Control Over Compliance

Management of HARC is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered HARC's internal control over compliance with the types of requirements that could have a direct and material effect on its major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for the major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, 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 program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or a 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 program will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

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 material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Blazek & Vetterling

July 26, 2019

Houston Advanced Research Center

Schedule of Findings and Questioned Costs for the year ended December 31, 2018

Section I – Summary of Auditors' Results

Financial Statements

Type of auditors' report issued: ☒ unmodified ☐ 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 auditors' report issued on compliance for major programs: ☒ unmodified ☐ qualified ☐ adverse ☐ disclaimer

Any audit findings disclosed that are required to be reported in accordance with 2 CFR §200.516(a)? ☐ yes ☒ no

Identification of major programs:

CFDA Number(s)	Name of Federal Program or Cluster
Various	Research and Development Cluster

Dollar threshold used to distinguish between Type A and Type B programs: $750,000

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 Award Findings and Questioned Costs

There were no findings for federal awards required to be reported in accordance with 2 CFR §200.516(a).