

# McGladrey & Pullen

Certified Public Accountants

## **Science Foundation Arizona**

Financial Report

12.31.2008

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# McGladrey & Pullen

Certified Public Accountants

## Independent Auditor's Report

To the Board of Directors  
Science Foundation Arizona  
Phoenix, Arizona

We have audited the accompanying statements of financial position of Science Foundation Arizona ("SFAz") as of December 31, 2008 and 2007, and the related statements of activities, and cash flows for the years then ended. These financial statements are the responsibility of SFAz's management. 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and 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 financial statements referred to above present fairly, in all material respects, the financial position of Science Foundation Arizona as of December 31, 2008 and 2007 and the changes in its net assets and its cash flows for years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 9 to the financial statements, the Organization has filed a claim with the Arizona Department of Commerce for payment of \$18,474,923 in contracts receivable at December 31, 2008. The Arizona Department of Commerce has denied the initial claim. Subsequently, SFAz sent a demand letter to the Arizona Department of Commerce for payment of the receivable under the terms of the contract. As of the date of this report, payment has not been received. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

*McGladrey & Pullen, LLP*

Phoenix, Arizona  
May 7, 2009

Science Foundation Arizona

Statements of Financial Position

December 31, 2008 and 2007

	2008			2007		
	Unrestricted	Temporarily Restricted	Total	Unrestricted	Temporarily Restricted	Total
<b>ASSETS</b>						
CURRENT ASSETS						
Cash and cash equivalents	\$ 34,408,968	\$ 21,524,394	\$ 55,933,362	\$ 33,076,711	\$ 22,837,829	\$ 55,914,540
Contract receivable (Note 9)	18,615,851	-	18,615,851	8,851,048	-	8,851,048
Contributions receivable, net (Note 3)	1,425,666	500,000	1,925,666	594,739	-	594,739
Prepaid expenses	19,949	-	19,949	10,987	-	10,987
<b>Total current assets</b>	<b>54,470,434</b>	<b>22,024,394</b>	<b>76,494,828</b>	<b>42,533,485</b>	<b>22,837,829</b>	<b>65,371,314</b>
Contract receivable	-	-	-	2,365,652	-	2,365,652
Contributions receivable, net (Note 3)	420,240	498,154	918,394	688,425	-	688,425
Equipment and leasehold improvements, net (Note 2)	386,019	-	386,019	370,439	-	370,439
Other assets	15,190	-	15,190	13,596	-	13,596
<b>Total assets</b>	<b>\$ 55,291,883</b>	<b>\$ 22,522,548</b>	<b>\$ 77,814,431</b>	<b>\$ 45,971,597</b>	<b>\$ 22,837,829</b>	<b>\$ 68,809,426</b>
<b>LIABILITIES AND NET ASSETS</b>						
CURRENT LIABILITIES						
Accounts payable	\$ 64,889	\$ -	\$ 64,889	\$ 156,632	\$ -	\$ 156,632
Grants payable	31,909,999	-	31,909,999	16,310,906	-	16,310,906
Contributions payable	20,000	-	20,000	120,000	-	120,000
Accrued expenses (Note 7)	275,678	-	275,678	93,160	-	93,160
Deferred revenue (Note 4)	5,264,084	-	5,264,084	19,985,179	-	19,985,179
<b>Total current liabilities</b>	<b>37,534,650</b>	<b>-</b>	<b>37,534,650</b>	<b>36,665,877</b>	<b>-</b>	<b>36,665,877</b>
Grants payable	14,196,451	-	14,196,451	6,765,652	-	6,765,652
Contribution payable	-	-	-	20,000	-	20,000
Commitments and contingencies (Notes 7 and 8)						
NET ASSETS						
Unrestricted - general	2,550,598	-	2,550,598	2,520,068	-	2,520,068
Unrestricted - board designated	1,010,184	-	1,010,184	-	-	-
Temporarily restricted (Note 5)	-	22,522,548	22,522,548	-	22,837,829	22,837,829
<b>Total net assets</b>	<b>3,560,782</b>	<b>22,522,548</b>	<b>26,083,330</b>	<b>2,520,068</b>	<b>22,837,829</b>	<b>25,357,897</b>
<b>Total liabilities and net assets</b>	<b>\$ 55,291,883</b>	<b>\$ 22,522,548</b>	<b>\$ 77,814,431</b>	<b>\$ 45,971,597</b>	<b>\$ 22,837,829</b>	<b>\$ 68,809,426</b>

See Notes to Financial Statements.

Science Foundation Arizona

Statements of Activities

Years Ended December 31, 2008 and 2007

	2008			2007		
	Unrestricted	Temporarily Restricted	Total	Unrestricted	Temporarily Restricted	Total
Revenues:						
State contract revenue	\$ 39,480,548	\$ -	\$ 39,480,548	\$ 28,784,521	\$ -	\$ 28,784,521
Contributions	3,179,190	1,800,000	4,979,190	2,443,979	25,450,000	27,893,979
Interest income	1,486,506	41,545	1,528,051	731,147	97,655	828,802
Amounts released from restriction	2,156,826	(2,156,826)	-	5,231,894	(5,231,894)	-
<b>Total revenues</b>	<b>46,303,070</b>	<b>(315,281)</b>	<b>45,987,789</b>	<b>37,191,541</b>	<b>20,315,761</b>	<b>57,507,302</b>
Program expenses:						
Grants	41,771,487	-	41,771,487	33,145,164	-	33,145,164
Grant administration	1,135,063	-	1,135,063	754,001	-	754,001
<b>Total program expenses</b>	<b>42,906,550</b>	<b>-</b>	<b>42,906,550</b>	<b>33,899,165</b>	<b>-</b>	<b>33,899,165</b>
Support expenses:						
Salaries and benefits (Note 8)	1,233,441	-	1,233,441	1,034,872	-	1,034,872
General and administrative	1,122,365	-	1,122,365	905,369	-	905,369
<b>Total support expenses</b>	<b>2,355,806</b>	<b>-</b>	<b>2,355,806</b>	<b>1,940,241</b>	<b>-</b>	<b>1,940,241</b>
Increase (decrease) in net assets	1,040,714	(315,281)	725,433	1,352,135	20,315,761	21,667,896
Net assets, beginning of year	2,520,068	22,837,829	25,357,897	1,167,933	2,522,068	3,690,001
Net assets, end of year	\$ 3,560,782	\$ 22,522,548	\$ 26,083,330	\$ 2,520,068	\$ 22,837,829	\$ 25,357,897

See Notes to Financial Statements.

Science Foundation Arizona

Statements of Cash Flows

Years Ended December 31, 2008 and 2007

	2008	2007
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Increase in net assets	\$ 725,433	\$ 21,667,896
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Bad debt expense	112,500	45,000
Depreciation and amortization	126,202	62,167
In-kind donations	75,000	(3,048)
Changes in operating assets and liabilities:		
Contract receivable	(7,399,151)	(11,216,700)
Contributions receivable	(1,748,396)	(550,154)
Prepaid expenses	(8,962)	(2,804)
Other assets	(1,594)	-
Accounts payable	(91,743)	148,692
Grants payable	23,029,892	23,076,558
Contributions payable	(120,000)	140,000
Accrued expenses	182,518	35,909
Deferred revenue	(14,721,095)	14,357,941
<b>Net cash provided by operating activities</b>	<b>160,604</b>	<b>47,761,457</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of equipment and leasehold improvements	(141,782)	(254,918)
<b>Net cash used in investing activities</b>	<b>(141,782)</b>	<b>(254,918)</b>
<b>Increase in cash and cash equivalents</b>	<b>18,822</b>	<b>47,506,539</b>
Cash and cash equivalents, beginning of year	55,914,540	8,408,001
Cash and cash equivalents, end of year	<b>\$ 55,933,362</b>	<b>\$ 55,914,540</b>
<b>SUPPLEMENTAL SCHEDULE OF INVESTING ACTIVITIES</b>		
In-kind donations of equipment and artwork	\$ -	\$ 3,048

See Notes to Financial Statements.

## Science Foundation Arizona

### Notes to Financial Statements

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#### **Note 1. Organization and Summary of Significant Accounting Policies**

##### **Organization:**

Science Foundation Arizona (“SFAz”) is a nonprofit Arizona corporation that was organized as a public foundation in February 2006 by three CEO groups: Flagstaff 40, Greater Phoenix Leadership, and Southern Arizona Leadership Council. The purpose of the Organization is to build and strengthen medical, scientific and engineering research programs and infrastructure in areas of greatest strategic value to Arizona’s competitiveness in the global economy and to actively engage scientific research, academic and medical institutions representing both the public and private sectors on a worldwide basis.

During 2008, SFAz created two additional operating divisions: Science Technology Engineering Mathematics Arizona (STEM) and Solar Technology Institute Arizona (Solar Institute). The activities for these two divisions are included in the statement of financial position and statement of activities. As discussed in Note 9, these divisions were established as separate legal entities in January 2009.

##### **A summary of SFAz’s significant accounting policies follows:**

##### **Basis of accounting:**

SFAz’s financial statements are presented on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

##### **Use of estimates:**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. A significant estimate is the allowance for uncollectible contributions and contract receivables.

##### **Cash and cash equivalents:**

Cash and cash equivalents include cash on hand, amounts due from banks, and money market accounts. SFAz maintains amounts due from banks, which at times, may exceed federally insured limits. SFAz has not experienced any losses in such accounts.

##### **Contract receivable:**

Contract receivable represents amounts billed to the Arizona Department of Commerce for grants which have been approved as of December 31, 2008 but have not been funded. As discussed in Note 9, SFAz has sent a demand letter for full payment of the contract receivable at December 31, 2008. SFAz believes this amount is fully collectible and has no allowance at December 31, 2008.

## Science Foundation Arizona

### Notes to Financial Statements

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#### Note 1. Organization and Summary of Significant Accounting Policies (Continued)

##### **Contributions:**

Gifts of cash and other assets are presented as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction is satisfied, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. Donor restricted contributions whose requirements are met in the same reporting period are reported as unrestricted support.

##### **Promises to give:**

Unconditional promises to give that are expected to be collected within one year are recorded at net realizable value. Unconditional promises to give that are expected to be collected in future years are recorded at the present value of their estimated future cash flows. The discounts on those amounts are computed using risk-free interest rates applicable to the years in which the promises are received. Amortization of the discounts is included in contribution revenue.

##### **Equipment and leasehold improvements:**

Equipment and leasehold improvements are recorded at cost and are depreciated using the straight-line method. Estimated lives range from three to five years for equipment and furniture. Leasehold improvements are depreciated over the lesser of the life of the lease or the life of the improvements.

##### **Grants payable:**

Grants payable represent unconditional grant monies which were approved by the Board of Directors prior to December 31, 2008 but have not been paid as of December 31, 2008. These grants are to be paid over the next four years.

##### **Contribution payable:**

Contribution payable represents an amount that SFAz has committed to contribute to another organization. The total contribution amount of \$150,000 was committed in 2007 and is to be paid over fifteen months in \$10,000 installments. As of December 31, 2008, there is \$20,000 remaining to be paid during 2009.

##### **Net assets:**

Unrestricted net assets include those funds presently available for use by SFAz at the discretion of management. The Board of Directors has placed a designation on certain cash accounts in the amount of \$1,010,184 in connection with anticipated expenditures in the event state funding is not renewed.

Temporarily restricted net assets are comprised of contributions subject to donor restrictions which will be satisfied either by the passage of time or by actions of SFAz.

Permanently restricted net assets consist of funds that are subject to the donor's specifications that the principal balance be invested and only the interest and dividend income or a portion of the income is available for restricted purposes as specified by the donor or, if not specified, for unrestricted purposes at the discretion of management. There are no permanently restricted net assets at December 31, 2008 or 2007.

## Science Foundation Arizona

### Notes to Financial Statements

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#### Note 1. Organization and Summary of Significant Accounting Policies (Continued)

##### Grant and contract revenue:

Revenue from grants and contracts is recognized according to the terms of the specific agreements. Generally, revenue from cost reimbursement grants is recognized to the extent of grant expenditures incurred. Grants and contracts are subject to audit by the awarding agency. At December 31, 2008 and 2007, approximately \$5,300,000 and \$19,900,000, respectively, has been received by the organization and is included as deferred revenue on the statement of financial position. The revenue will be recognized as the related grant expenses are incurred.

##### Program expenses:

Included within program expenses for the year ended December 31, 2008 are the approved grant expenditures of approximately \$41,800,000, certain general and administrative expenses directly related to the grant review, approval and monitoring process of approximately \$291,000 and approximately \$844,000 of salaries and benefits for SFAz personnel specifically assigned to oversee grants. Included within program expenses for the year ended December 31, 2007 are the approved grant expenditures of approximately \$33,150,000, certain general and administrative expenses directly related to the grant review, approval and monitoring process of approximately \$372,000, and approximately \$382,000 of salaries and benefits for SFAz personnel specifically assigned to oversee grants.

##### Rent expense:

SFAz records rent expense on a straight-line basis over the term of the lease. Rent expense is included in general and administrative expenses on the statement of activities.

##### Reclassifications

Certain reclassifications have been made to the 2007 financial statements to comply with the presentation adopted as of and for the year ended December 31, 2008, with no effect on net assets or cash flows.

##### Recent accounting pronouncements:

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with Statement No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition of tax benefits, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure, and transition.

In December 2008, the FASB provided for a deferral of the effective date of FIN 48 for certain nonpublic enterprises to annual financial statements for fiscal years beginning after December 15, 2008. SFAz has elected this deferral and accordingly will be required to adopt FIN 48 in its 2009 annual financial statements. Prior to adoption of FIN 48, SFAz will continue to evaluate its uncertain tax positions and related income tax contingencies under SFAS No. 5, *Accounting for Contingencies*. SFAS No. 5 requires the Foundation to accrue for losses that are probable and can be reasonably estimated. Management is currently assessing the impact of FIN 48 on its financial position and results of operations and has not yet determined if the adoption of FIN 48 will have a material effect on its financial statements.

## Science Foundation Arizona

### Notes to Financial Statements

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#### Note 1. Organization and Summary of Significant Accounting Policies (Continued)

##### Recent accounting pronouncements (continued):

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurement. SFAS No. 157 also emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets. Under SFAS No. 157, fair value measurements are disclosed by level within that hierarchy. In February 2008, the FASB issued FASB Staff Position No. 157-2, *Effective Date of FASB Statement No. 157*, which permits a one-year deferral for the implementation of SFAS No. 157 with regard to nonfinancial assets and liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis. SFAz adopted SFAS No. 157 as of January 1, 2008, except for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis for which delayed application is permitted until our fiscal year beginning January 1, 2009. There was no material effect of the adopted provisions of SFAS No. 157. Management is currently assessing the impact of FASB Staff Position No. 157-2, *Effective Date of FASB Statement No. 157* on its financial position and activities and has not yet determined if its adoption will have a material effect on its financial statements.

In August 2008, The FASB issued FASB Staff Position (FSP) No. 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds*. Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds, this FSP provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Law Commission (ULC; formerly known as the National Conference of commissioners about an organizations' endowment funds (both donor-restricted endowment funds and board designated endowment funds), whether or not the organization is subject to UPMIFA. Among its changes, UPMIFA prescribes new guidelines for expenditure of donor-restricted endowment fund (in the absence of overriding, explicit donor stipulations). The FSP is effective for fiscal years ending after December 15, 2008. The adoption of FSP No. 117-1 did not have a material impact on SFAz's financial statements.

#### Note 2. Equipment and Leasehold Improvements

Equipment and leasehold improvements consist of the following as of December 31:

	2008	2007
Leasehold improvements	\$ 345,971	\$ 240,281
Equipment, furniture and fixtures	250,784	214,692
	<u>596,755</u>	<u>454,973</u>
Less accumulated depreciation	210,736	84,534
	<u>\$ 386,019</u>	<u>\$ 370,439</u>

## Science Foundation Arizona

### Notes to Financial Statements

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#### Note 3. Grants and Contributions

Contributions receivable consist of the following as of December 31:

	2008	2007
Contributions to be collected:		
Within one year	\$ 1,968,666	\$ 637,739
In one to five years	921,592	725,000
	<u>2,890,258</u>	<u>1,362,739</u>
Less:		
Discount for the time-value of money	(3,198)	(36,575)
Allowance for uncollectible contributions	(43,000)	(43,000)
Contributions receivable, net	<u>\$ 2,844,060</u>	<u>\$ 1,283,164</u>

#### Note 4. Deferred Revenue

In October 2007, SFAz received approval for a \$25,000,000 contract extension with the Arizona Department of Commerce to be funded by the Arizona 21<sup>st</sup> Century Fund. SFAz intends to disburse these monies as grants through 2009. As of December 31, 2007, SFAz had received \$25,000,000 from the Arizona 21<sup>st</sup> Century Fund, of which \$5,000,000 had been committed for grants and is included in grants payable on the statement of financial position, and \$14,821 had been used for grant related expenses. The remaining \$19,985,179 is included in deferred revenue as of December 31, 2007 on the statement of financial position.

During the year ended December 31, 2008, SFAz had committed an additional \$16,747,876 for grants, which is included in grants payable on the statement of financial position, and \$473,219 had been used for grant related expenses. The remaining \$2,764,084 is included in deferred revenue as of December 31, 2008 on the statement of financial position.

During 2008, SFAz received \$2,500,000 from the Arizona State Board of Education to fund grants through STEM. As of December 31, 2008, no grants have been committed and the balance is included in deferred revenue.

#### Note 5. Restricted Net Assets

Temporarily restricted net assets are donor restricted net assets, which are to be released from restrictions when the purpose is met. As of December 31, 2008 and 2007, there are approximately \$23,000,000 of temporarily restricted net assets which are available for use in future years for purposes other than operations, as set forth by the donor.

#### Note 6. Taxes

SFAz is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code. Accordingly, no provision for federal income taxes has been included in the accompanying financial statements.

## Science Foundation Arizona

### Notes to Financial Statements

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#### Note 7. Commitments and Contingencies

##### Lease commitments:

The Organization has subleased office space under a noncancellable operating lease agreement which expires on June 30, 2011, and requires escalating minimum annual rentals after two years of rent abatement. In addition, there is also a rent abatement for the last six months of the lease. The lease requires the payment of any rental, excise, sales or transaction privilege taxes, normal maintenance and repairs, insurance on the properties and additional rentals based on operating expenses that exceed a certain threshold.

Beginning August 1, 2008, the Organization leased an additional office space for STEM under a noncancellable operating lease agreement which expires on July 31, 2011, and requires escalating minimum annual rentals after one month of rent abatement. The lease requires the payment of any rental, excise, sales or transaction privilege taxes, normal maintenance and repairs, insurance on the properties and additional rentals based on operating expenses that exceed a certain threshold.

The total minimum rental commitment at December 31, 2008, is due as follows:

##### During the year ending December 31:

2009	\$	86,195
2010		86,739
2011		11,123
	\$	<u>184,057</u>

The Organization has recorded a deferred rent liability of \$45,720 and \$55,118 as of December 31, 2008 and 2007, respectively, which is included in accrued expenses on the statement of financial position. The total rental expense included in the statement of activities for the year ended December 31, 2008 and 2007 is approximately \$50,000 and \$37,000. In addition, the Organization received an in-kind contribution for rent of \$75,000 from the lessor for the years ended December 31, 2008 and 2007.

##### Employment agreements:

The Organization has an employment agreement with the President and CEO (CEO) for an initial term of five years ending on May 31, 2011, with automatic one-year renewal terms unless either party provides written notice to terminate the agreement. The CEO is eligible to receive a severance package under certain conditions as contained in the employment agreement.

#### Note 8. Retirement Plans

SFAz has a 401(k) plan covering substantially all of its employees. SFAz's contributions to the 401(k) plan are discretionary. During the years ended December 31, 2008 and 2007, SFAz matched up to 6% of employee contributions to the plan. Retirement plan expense was approximately \$71,000 and \$53,000, respectively, for the years ended December 31, 2008 and 2007.

## Science Foundation Arizona

### Notes to Financial Statements

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#### **Note 9. Subsequent Events**

##### **Subsidiaries:**

In January 2009, STEM and Solar Institute were established as single-member LLC's.

##### **Grant expense:**

As of May 7, 2009, SFAz has disbursed approximately \$11,000,000 in grant payments to various institutions in accordance with the grant agreements. These grants were included in grants payable as of December 31, 2008. The Board of Directors has approved approximately \$12,290,000 of new conditional grant awards from five grant programs to be paid out through 2011. \$1,000,000 of these awards are conditional on the recipient's meeting certain matching requirements. The remaining \$11,290,000 of awards are conditional on the recipient's meeting certain matching requirements and funding by the state of Arizona.

##### **Arizona funding:**

On February 17, 2009, the Arizona Department of Commerce issued a stop work order indicating they did not have funds appropriated to continue paying the Arizona 21<sup>st</sup> Century Fund contract and asked SFAz to clarify what was owed as of that date. The Arizona Department of Commerce denied the initial claim. In April 2009, SFAz sent a demand letter to the Arizona Department of Commerce for payment of \$18,474,923 for grants under the Arizona 21<sup>st</sup> Century Fund contract. The demand letter was then rejected. As of May 7, 2009, SFAz has not received payment in response to this letter.