

Northern California
Institute for Research and
Education, Inc.

(A California Nonprofit Public Benefit Corporation)

Financial Statements as of and for the Years
Ended September 30, 2009 and 2008, and
Independent Auditors' Report

**NORTHERN CALIFORNIA INSTITUTE FOR
RESEARCH AND EDUCATION, INC.
(A California Nonprofit Public Benefit Corporation)**

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INDEPENDENT AUDITORS' REPORT

To the Audit and Risk Management Committee
Northern California Institute for Research and Education, Inc.
San Francisco, California

We have audited the accompanying statements of financial position of Northern California Institute for Research and Education, Inc. (a California Nonprofit Public Benefit Corporation) (the "Institute") as of September 30, 2009 and 2008, and the related statements of activities and changes in net assets and of cash flows for the years then ended. These financial statements are the responsibility of the Institute'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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Institute's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and 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, such financial statements present fairly, in all material respects, the financial position of the Institute as of September 30, 2009 and 2008, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte + Touche LLP

April 5, 2010

**NORTHERN CALIFORNIA INSTITUTE FOR
RESEARCH AND EDUCATION, INC.**
(A California Nonprofit Public Benefit Corporation)

**STATEMENTS OF FINANCIAL POSITION
AS OF SEPTEMBER 30, 2009 AND 2008**

	2009	2008
ASSETS		
CASH AND CASH EQUIVALENTS	\$ 7,665,502	\$ 6,584,612
RECEIVABLES	5,808,060	8,200,119
PREPAID EXPENSES AND OTHER ASSETS	169,534	182,081
PROPERTY, PLANT, AND EQUIPMENT — Net	<u>3,839,336</u>	<u>4,231,515</u>
TOTAL	<u>\$ 17,482,432</u>	<u>\$ 19,198,327</u>
 LIABILITIES AND NET ASSETS		
LIABILITIES:		
Accounts payable	\$ 1,947,033	\$ 2,344,586
Accrued expenses	2,507,188	4,671,760
Due to federal government	2,096,022	1,044,509
Unearned revenue	5,913,483	3,872,860
Capital lease obligation	<u>46,857</u>	<u> </u>
Total liabilities	<u>12,510,583</u>	<u>11,933,715</u>
NET ASSETS:		
Unrestricted	4,493,696	6,791,211
Temporarily restricted	<u>478,153</u>	<u>473,401</u>
Total net assets	<u>4,971,849</u>	<u>7,264,612</u>
TOTAL	<u>\$ 17,482,432</u>	<u>\$ 19,198,327</u>

See notes to financial statements.

**NORTHERN CALIFORNIA INSTITUTE FOR
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**STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED SEPTEMBER 30, 2009 AND 2008**

	2009			2008		
	Unrestricted	Temporarily Restricted	Total	Unrestricted	Temporarily Restricted	Total
REVENUES AND OTHER SUPPORT:						
Federal contracts and grants	\$ 39,711,843	\$ -	\$ 39,711,843	\$ 44,725,187	\$ -	\$ 44,725,187
Clinical research revenue	1,285,365		1,285,365	1,664,612		1,664,612
Foundation and other grants	1,666,720		1,666,720	1,988,269		1,988,269
Contributions	115,354	58,762	174,116	268,776	100,537	369,313
Service revenue	331,962		331,962	646,752		646,752
Interest income	12,716		12,716	57,962		57,962
Other income	3,769		3,769	18,412		18,412
Net assets released from restrictions	54,010	(54,010)	-	66,814	(66,814)	-
Total revenues and other support	<u>43,181,739</u>	<u>4,752</u>	<u>43,186,491</u>	<u>49,436,784</u>	<u>33,723</u>	<u>49,470,507</u>
OPERATING EXPENSES:						
Research program expenses	31,590,745		31,590,745	37,378,891		37,378,891
Management and general expenses	13,567,549		13,567,549	13,114,958		13,114,958
Fundraising expenses	248,529		248,529	178,343		178,343
Total operating expenses	<u>45,406,823</u>	<u>-</u>	<u>45,406,823</u>	<u>50,672,192</u>	<u>-</u>	<u>50,672,192</u>
DISTRIBUTIONS UPON TRANSFER OF INVESTIGATORS	<u>(72,431)</u>		<u>(72,431)</u>			<u>-</u>
(DECREASE) INCREASE IN NET ASSETS	(2,297,515)	4,752	(2,292,763)	(1,235,408)	33,723	(1,201,685)
NET ASSETS — Beginning of year	<u>6,791,211</u>	<u>473,401</u>	<u>7,264,612</u>	<u>8,026,619</u>	<u>439,678</u>	<u>8,466,297</u>
NET ASSETS — End of year	<u>\$ 4,493,696</u>	<u>\$ 478,153</u>	<u>\$ 4,971,849</u>	<u>\$ 6,791,211</u>	<u>\$ 473,401</u>	<u>\$ 7,264,612</u>

See notes to financial statements.

**NORTHERN CALIFORNIA INSTITUTE FOR
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**STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED SEPTEMBER 30, 2009 AND 2008**

	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES:		
Decrease in net assets	\$ (2,292,763)	\$ (1,201,685)
Adjustment to reconcile decrease in net assets to net cash provided by (used in) operating activities:		
Depreciation	815,485	806,336
Transfer of equipment	72,431	
Loss on write-off of equipment	5,470	
Changes in:		
Receivables	2,392,059	(1,353,696)
Prepaid expenses and other assets	12,547	33,753
Accounts payable	(342,825)	38,905
Accrued expenses and due to federal government	(1,113,059)	1,261,802
Unearned revenue	<u>2,040,623</u>	<u>(530,389)</u>
Net cash provided by (used in) operating activities	1,589,968	(944,974)
CASH FLOWS FROM INVESTING ACTIVITIES — Purchases of property, plant, and equipment	(499,133)	(401,449)
CASH FLOWS FROM FINANCING ACTIVITIES — Payments on capital lease	<u>(9,945)</u>	<u> </u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	1,080,890	(1,346,423)
CASH AND CASH EQUIVALENTS — Beginning of year	<u>6,584,612</u>	<u>7,931,035</u>
CASH AND CASH EQUIVALENTS — End of year	<u>\$ 7,665,502</u>	<u>\$ 6,584,612</u>
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES:		
Accrued purchases of property, plant, and equipment	<u>\$ -</u>	<u>\$ 54,728</u>
Acquisition of equipment through a capital lease agreement	<u>\$ 56,802</u>	<u>\$ -</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION — Interest paid	<u>\$ 2,242</u>	<u>\$ -</u>

See notes to financial statements.

**NORTHERN CALIFORNIA INSTITUTE FOR
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**NOTES TO FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED SEPTEMBER 30, 2009 AND 2008**

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Organization — Northern California Institute for Research and Education, Inc. (a California nonprofit public benefit corporation) (the “Institute”) was formed in 1988 as a research institute affiliated with the San Francisco Veterans Affairs Medical Center (VA). The Institute works with sponsors and the VA in administering funds for conducting research to find new and improved ways to combat human disease and impairments of man.

Basis of Accounting — The financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

The Institute reports information regarding its financial position and activities according to three classes of net assets as follows:

Unrestricted Net Assets — Net assets that are not subject to donor-imposed restrictions. Unrestricted net assets may be designated for specific purposes by action of the Board of Directors or otherwise limited by contractual arrangements with outside parties.

Temporarily Restricted Net Assets — Net assets that are subject to donor-imposed restrictions that can be fulfilled either by actions of the Institute pursuant to those restrictions and/or expire with the passage of time.

Permanently Restricted Net Assets — Net assets that are subject to donor-imposed restrictions that are required to be retained in perpetuity by the Institute.

During the reporting period, the Institute had only unrestricted and temporarily restricted net assets. Temporarily restricted net assets at September 30, 2009 and 2008, related primarily to contributions for which the research funds had not yet been spent for the purpose designated by the donor.

Revenue Recognition — The Institute administers several different types of research agreements, including those that are reciprocal and nonreciprocal (charitable) in nature.

Reciprocal agreements are either on a cost-reimbursement basis or on a per-patient payment schedule. Revenues under such agreements are recognized as the services are conducted, using the percentage-of-completion method, measured by per-patient studies. Grant revenue is recognized when earned, generally in proportion to the expenses incurred. Advance payments and signed agreements from sponsors are classified as unearned revenue and recognized as revenue upon the expenditure of allowable costs or completion of the various stages of the studies.

Nonreciprocal revenues or contributions are reported as increases in unrestricted net assets, unless their use is limited by donor-imposed restrictions or conditions. Expirations of donor-imposed restrictions (i.e., the donor-stipulated purpose or time restriction has been satisfied) are reported as net assets released from restrictions.

The Institute's policy is that if a restriction is fulfilled in the same fiscal year in which the contribution is received, the Institute records it as temporarily restricted revenue and as net assets released from restrictions.

Foundation and other grants are not included as support until all conditions are substantially met. At September 30, 2009 and 2008, the Institute had received in advance conditional contributions of \$386,695 and \$479,261, respectively, which are reported in unearned revenue in the statements of financial position. At September 30, 2009 and 2008, the Institute had received notification of \$2,352,523 and \$2,161,150, respectively, of conditional commitments from foundations to fund research. These amounts will not be recorded by the Institute until the donor-imposed conditions (incurring allowable costs to be reimbursed) are met or an advance is received.

Program Income — Program income earned from fees related to services provided on a grant sponsored activity amounted to \$159,000 and \$214,500 for the years ended September 30, 2009 and 2008, respectively, and is included within service revenue on the statements of activities and changes in net assets. Such funds are required to be expended on the grant sponsored activity.

Cash and Cash Equivalents — Cash and cash equivalents consist of cash held in checking and money market accounts.

Property, Plant, and Equipment — Property, plant, and equipment are stated at cost. Depreciation is calculated on the straight-line method over the estimated useful lives of assets which range from 3 to 30 years. For the years ended September 30, 2009 and 2008, the Institute incurred depreciation expense in the amount of \$815,485 and \$806,336, respectively.

Income Taxes — The Institute is a nonprofit corporation and is generally exempt from federal income tax under Internal Revenue Code Section 501(c)(3) and state tax under California Revenue and Taxation Code Section 23701(d).

Concentrations of Risk — The Institute maintains cash balances at various financial institutions which, at times, may exceed federally insured limits.

The Institute is funded primarily by government agencies. During the years ended September 30, 2009 and 2008, respectively, the Department of Health and Human Services accounted for 80% and 83% of federal contract and grant revenue, respectively.

Use of Estimates — The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the reporting date and revenues and expenses during the reporting period. Actual results could differ from those estimates.

Subsequent Events — The Institute has evaluated subsequent events through April 5, 2010, the date on which the financial statements were issued.

2. PROPERTY, PLANT, AND EQUIPMENT

Property, plant, and equipment at September 30, 2009 and 2008, consisted of the following:

	2009	2008
Building	\$ 999,680	\$ 993,935
Furniture and office equipment	565,899	402,174
Medical and research equipment	<u>5,851,354</u>	<u>5,975,078</u>
Total	7,416,933	7,371,187
Less accumulated depreciation	<u>(3,577,597)</u>	<u>(3,139,672)</u>
Property, plant, and equipment — net	<u>\$ 3,839,336</u>	<u>\$ 4,231,515</u>

At September 30, 2009, equipment under a capital lease totaled \$51,392.

3. RETIREMENT PLANS

403(b) Savings Plan — The Institute’s employees participate in a 403(b) savings plan (the “Plan”). The Plan is open to all employees beginning at the date of hire. The Plan allows contributions by participants of amounts ranging from 0% to 15% of compensation based on limits defined by the Internal Revenue Code. The Institute does not contribute to the Plan.

Defined Contribution Plan — The Institute’s employees participate in a 401(a) defined contribution plan (the “401(a) Plan”). The 401(a) Plan is open to employees that meet certain eligibility requirements. The Institute makes annual contributions of 10% of eligible employee compensation. The Institute contributed \$870,548 and \$862,250 to the 401(a) Plan for the years ended September 30, 2009 and 2008, respectively.

4. RELATED-PARTY TRANSACTIONS

The majority of the Institute’s Board of Directors are employed or affiliated with the VA and/or the University of California, San Francisco (UCSF). All of the principal investigators hold academic positions at UCSF. The Institute pays the VA for various research-related services, including pharmacy, animal care, and other services, as well as certain personnel costs, in which the employee performs services for both entities. The Institute, the VA, and UCSF reimburse one another for costs associated with these activities. During the years ended September 30, 2009 and 2008, the Institute incurred such costs in the amount of \$10,435,964 and \$10,335,033, respectively, and was reimbursed \$2,555,307 and \$2,452,171, respectively, in relation to these types of services. At September 30, 2009 and 2008, the Institute had payables due to the VA and/or UCSF in the amounts of \$884,327 and \$986,462, respectively, for these services. These amounts are reported within accounts payable and accrued expenses. At September 30, 2009 and 2008, the Institute had receivables due from the VA and/or UCSF in the amounts of \$653,773 and \$800,742, respectively. These amounts are reported within receivables.

5. COMMITMENTS AND CONTINGENCIES

Research Agreements — Certain research agreements require fulfillment of various procedures. Failure to fulfill those procedures could result in the return of funds to the sponsor(s). In addition, all federal awards are subject to audit under the U.S. Office of Management and Budget Circular A-133 and by various federal agencies. To date, there have not been any significant adjustments related to research agreements.

Indirect Costs — The Institute negotiates its indirect cost agreement with the Department of Health and Human Services (DHHS). The negotiations resulted in a provisional rate of 55% for fiscal years 2009 and 2008, respectively. The rates were determined using estimated indirect costs as a function of estimated direct costs. If actual costs are lower than these estimates, the Institute will make a downward adjustment to its draw of federal funds in order to appropriately reflect actual indirect costs for the period.

Based on the final indirect rate of 48.2% issued by DHHS for fiscal year 2007, the Institute made an adjustment to the billing rate which resulted in a payable at September 30, 2009 to the federal government in the amount of \$1,026,215. The estimated final indirect rate of 48.9% for fiscal year 2008 resulted in a payable due to the federal government at September 30, 2009, in the amount \$1,069,807.

Operating Leases — At September 30, 2009, the Institute leased space under an operating lease that will expire in July 2012. Future minimum lease payments are as follows:

2010	\$ 35,277
2011	36,689
2012	<u>31,586</u>
Total	<u>\$ 103,552</u>

Total rental expense for the years ended September 30, 2009 and 2008, was \$69,112 and \$71,334, respectively.

Capital Lease — At September 30, 2009, the Institute leased equipment under a capital lease that will expire in February 2012. Future minimum lease payments are as follows:

2010	\$ 20,891
2011	20,891
2012	<u>8,705</u>
Total	50,487
Less amount representing interest	<u>(3,630)</u>
Present value of net minimum lease payments	<u>\$ 46,857</u>

6. DISTRIBUTION UPON TRANSFERS OF INVESTIGATORS

Research projects may transfer to other nonprofit research facilities as a result of relocations or transfers of principal investigators. When this occurs, the remaining funds and equipment that are designated for that project are sent to the other research facility. The Institute treats transfers as a nonoperating distribution of net assets in its statements of activities and changes in net assets. Those distributions and equipment amounted to \$72,431 and \$0 for the years ended September 30, 2009 and 2008, respectively.

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