

***The Ohio State University
Research Foundation
(A Component Unit of The Ohio
State University)***

*Financial Statements as of and for the
Years Ended June 30, 2006 and 2005,
and Independent Auditors' Report*

THE OHIO STATE UNIVERSITY RESEARCH FOUNDATION
(A Component Unit of The Ohio State University)

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
The Ohio State University Research Foundation
Columbus, Ohio

We have audited the accompanying statements of net assets of The Ohio State University Research Foundation (the "Research Foundation"), a component unit of The Ohio State University, as of June 30, 2006 and 2005, and the related statements of revenues, expenses, and changes in net assets, and of cash flows for the years then ended. These financial statements are the responsibility of the Research Foundation'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 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 the audit to obtain reasonable assurance about whether the respective 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 Research Foundation'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 respective 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 respective financial position of the Research Foundation as of June 30, 2006 and 2005, and its changes in net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis ("MD&A") on pages 2 through 8 is not a required part of the financial statements, but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Research Foundation's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and we do not express an opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 29, 2006, on our consideration on internal control over financial reporting and 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.



December 29, 2006

THE OHIO STATE UNIVERSITY RESEARCH FOUNDATION

(A Component Unit of The Ohio State University)

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2006

The following Management's Discussion and Analysis, or MD&A, provides an overview of the financial position and operations of The Ohio State University Research Foundation (the "Research Foundation") for the years ended June 30, 2006 and 2005, with comparative information for the year ended June 30, 2005. We encourage you to read this MD&A section in conjunction with the audited financial statements and footnotes appearing in this report.

About the Financial Statements

The Research Foundation has implemented a governmental financial reporting model, which is set forth in Governmental Accounting Standards Board ("GASB") Statement Nos. 34 and 35. Under these accounting standards, the Research Foundation will present its financial reports in a single-column "business-type activity" format. GASB Statement No. 35 defines business-type activities as those financed in whole or in part by fees charged to external parties for goods and services. Most public colleges and universities have elected to use the business-type activity format.

In addition to this MD&A section, the financial report includes a statement of net assets, a statement of revenues, expenses, and changes in net assets, statement of cash flows, and footnotes.

The statement of net assets is the Research Foundation's balance sheet. It reflects the total assets, liabilities, and net assets (equity) of the Research Foundation as of June 30, 2006, with comparative information as of June 30, 2005. Liabilities due within one year, and assets available to pay those liabilities, are classified as current. Other assets and liabilities are classified as noncurrent. Investment assets are carried at market value. Capital assets, which include the Research Foundation's furniture and equipment, are shown net of accumulated depreciation. Net assets are grouped in the following categories:

- Invested in capital assets, net of plant debt
- Restricted—Nonexpendable (endowment and annuity funds)
- Restricted—Expendable (primarily current restricted and loan funds)
- Unrestricted

The statement of revenues, expenses, and changes in net assets is the Research Foundation's income statement. It details how net assets have increased (or decreased) during the Fiscal Year that ended June 30, 2006, with comparative information for Fiscal Year 2005. Depreciation is provided for capital assets, and there are required subtotals for net operating income or loss and net income or loss before additions to nonexpendable funds.

It should be noted that the required subtotal for net operating income or loss will generally reflect a loss for the Research Foundation. This is primarily due to the way operating and nonoperating items are being reported. Operating expenses include virtually all Research Foundation expenses. Operating revenues, however, exclude certain significant revenue streams, including our corporate operating budget. Under this paradigm, our operating loss will increase or decrease based upon the amount of our corporate operating budget.

The statement of cash flows details how cash has increased (or decreased) during the year ended June 30, 2006, with comparative information for Fiscal Year 2005. It breaks out the sources and uses of Research Foundation cash into the following categories:

- Operating activities
- Noncapital financing activities
- Capital and related financing activities
- Investing activities

Cash flows associated with the Research Foundation's expendable net assets appear in the operating and noncapital financing categories. Capital financing activities include payments for capital assets, proceeds from long-term debt, and debt repayments. Purchases and sales of investments are reflected as investing activities.

The footnotes, which follow the financial statements, provide additional details on the numbers in the financial statements.

General

The Ohio State University Research Foundation is a nonprofit corporation created as a vehicle to promote sponsored research at The Ohio State University (the "University").

In November 1936, the Ohio Secretary of State issued a charter to The Ohio State University Research Foundation as a nonprofit educational corporation. Incorporators of the Research Foundation included the renowned inventor Charles F. Kettering and James F. Lincoln, president of the Lincoln Electric Company. The Board of Directors consists of the following member directors:

Trustee Member (1):

Appointed by the Board of Trustees of the University.

University Administration Members (3):

Including the Vice President for Research, the Executive Vice President for Academic Affairs and Provost, and the Dean of the Graduate School as designated by the Board of Trustees of the University.

Faculty Members (4):

Selected from the faculty by the Research Committee of the University Senate.

Alumni Members (2):

Designated by The Ohio State University Alumni Association from alumni of the University.

At-Large (1):

Designated by the President of the University from among members of national organizations of distinguished engineers, scientists, and scholars.

The Research Foundation Board of Directors elects officers during the regular annual meeting. The officers include President, Vice President, Secretary, Assistant Secretary, Treasurer, and Executive Director of the Research Foundation. The Directors appoint an Executive Committee and other committees as needed.

The function of the Research Foundation has evolved over the years in response to the needs of the research community within the University. The Research Foundation began as an organization created to encourage industry sponsorship of University research. It now provides specialized integrated administrative and financial services for research and other activities supported by a wide range of external sponsors.

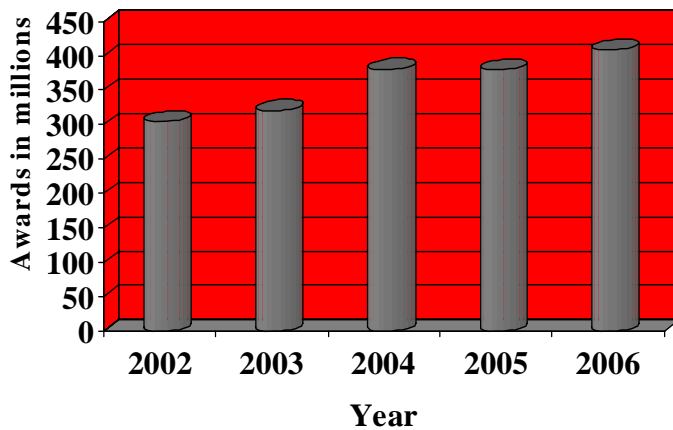
The Research Foundation does not own or operate research facilities but utilizes facilities provided by the University under an agreement between the Board of Trustees of the University and the Research Foundation. Personnel working on Research Foundation projects are appointed as University personnel and are paid through the University under provisions of the agreement. The Research Foundation Board of Directors approves the operating budget for the Research Foundation's administrative expenses.

Financial Highlights and Key Trends

To support our continued growth in sponsored project research, the Research Foundation is partnering with the University and is now processing all sponsored project transactions within the PeopleSoft Grants system. One benefit of sharing the same financial system with the University is that the historical receivables and payables balances with the University have been eliminated and no new balances will be created in the future.

In Fiscal Year 2006, awards were approximately \$408 million, an 8% increase from Fiscal Year 2005 of \$379 million. There was a 6% decrease this year in federal awards that was offset by significant increases in non-federal awards. The National Institutes of Health accounted for the only significant federal growth. The increase in non-federal awards was largely the result of increased funding from the State of Ohio.

Award Growth



Sponsor revenues and expenditures in Fiscal Year 2006 increased by \$21 million (6%) to \$367 million. Most of the increase can be attributed to federal sponsors. The increase in expenditures generated a corresponding 7% increase in Facilities and Administrative expense recovery.

Statement of Net Assets

From June 30, 2005 to June 30, 2006, the cash balance decreased by \$7.3 million (36%). The primary cause of this reduction in cash was a decline in deferred revenue. The decline in deferred revenue was due to the amount of cash advanced from sponsors being relatively stable throughout the year, while expenditures against these advances increased significantly in the second half of the year. The secondary cause of the reduction in the cash balance is that payments from the State of Ohio have been delayed because of burdensome cost-share agreements. As of June 30, 2006, \$4.1 million in State of Ohio invoices remain unpaid. The statement of cash flows, which is discussed in more detail below, provides additional detail on the sources and the uses of Research Foundation cash.

Following is a summary of the major components of the net assets of the Research Foundation for the years ended June 30, 2006 and 2005:

	2006	2005	2004
CURRENT ASSETS	\$61,133,022	\$75,220,442	\$85,318,531
CAPITAL ASSETS—furniture and equipment	<u>639,373</u>	<u>817,959</u>	<u>931,029</u>
Total assets	<u>\$61,772,395</u>	<u>\$76,038,401</u>	<u>\$86,249,560</u>
CURRENT LIABILITIES	\$53,291,856	\$69,239,077	\$80,110,655
NONCURRENT LIABILITIES			
—accrued vacation and sick leave	<u>358,900</u>	<u>386,451</u>	<u>223,146</u>
Total liabilities	<u>53,650,756</u>	<u>69,625,528</u>	<u>80,333,801</u>
Net assets:			
Invested in capital assets	639,373	817,959	931,029
Unrestricted	<u>7,482,266</u>	<u>5,594,914</u>	<u>4,984,730</u>
Total net assets	<u>8,121,639</u>	<u>6,412,873</u>	<u>5,915,759</u>
Total liabilities and net assets	<u>\$61,772,395</u>	<u>\$76,038,401</u>	<u>\$86,249,560</u>

Accounts receivable and unbilled project costs decreased \$7.1 million (13%) this year primarily due to improved billing, reporting, and collections processing. Under the current billing paradigm approximately \$4 million a month in fringe benefit expense cannot be drawn and deposited until after month-end. The Research Foundation is requesting that improvements be made to the University Payroll system that will facilitate collecting this cash by month-end.

Our Facilities and Administrative costs payable to the University decreased \$5.0 million (22%) this year because of improved reconciliation and remittance practices. For 2006 and 2005, the Research Foundation remitted Facilities and Administrative balances payable to the University on a quarterly basis.

2005–2004 Highlights—From June 30, 2005 to June 30, 2004, our cash balance decreased to \$21 million (51%). Two factors were primarily responsible for the sharp decline in our cash balance. First, as of July 31, 2004, the Research Foundation settled \$10 million of inter-company payables with the University. Second, the Research Foundation now reimburses the University for sponsored project expenses as the expenses are incurred. This is often 60 days before the Research Foundation is reimbursed by the project sponsor. In past years, the payments from the sponsor and the subsequent reimbursement to the University were more closely timed. Both of these actions resulted in permanent reductions to Research Foundation cash balances. In addition, while gaining experience with the PeopleSoft billing system, the Research Foundation experienced an average increase in the monthly sponsor billing cycle of 15 days during fiscal year 2005. As of August 2005, the Research Foundation had returned to the standard billing cycle.

Statement of Revenues, Expenses, and Changes in Net Assets

We experienced another year of significant growth in sponsored project revenue and expenditures. Our sponsored project revenue/expenditures increased by \$21 million (6%) from last year with the largest growth areas being sponsored project personnel expenditures and sponsored project materials and services. These two categories accounted for \$5 million and \$7 million of the \$21 million increase, respectively. The growth in materials and services expense produced a significant increase in transaction volume in our Procurement area.

The increase in Depreciation expense is attributable to taking a full year's depreciation of the PeopleSoft Grants Management software. By rule, we took only six months of depreciation expense on this asset in 2005.

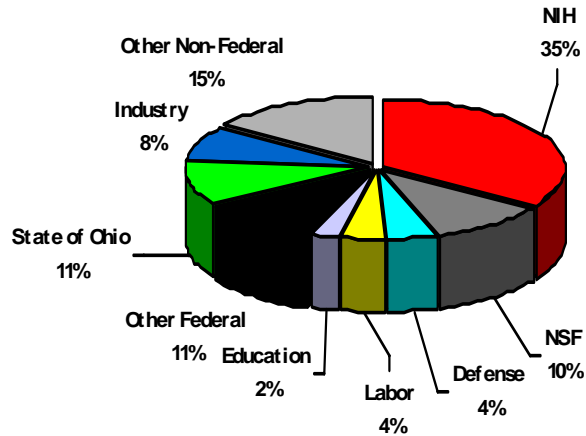
Net Interest revenue increased by approximately \$274,000 due to higher average cash balances for the first half of the year coupled with increasing interest rates for the entire year.

We recognize Sponsored Project Revenue as Sponsored Project Expenses are incurred. The excerpt below from our statement of revenues, expenses, and changes in net assets demonstrates this relationship.

	2006	2005	2004
SPONSOR PROJECT REVENUE	<u>\$ 366,960,720</u>	<u>\$ 345,776,754</u>	<u>\$ 314,753,335</u>
EXPENDITURES AND TRANSFERS:			
Sponsored project expenses:			
Personnel	\$ 171,453,117	\$ 166,391,512	\$ 143,319,889
Materials and services	98,620,780	91,679,208	86,085,869
Equipment	12,598,407	9,652,710	11,416,169
Travel	7,701,097	6,532,025	6,344,233
F&A charged by the University	76,587,319	71,521,299	67,587,175
Other	<u>7,378,637</u>	<u>7,745,588</u>	<u>8,283,540</u>
TOTAL OPERATING EXPENDITURES	<u>374,339,357</u>	<u>353,522,342</u>	<u>323,036,875</u>
NONOPERATING INCOME	<u>9,087,403</u>	<u>8,242,702</u>	<u>7,727,068</u>
CHANGE IN NET ASSETS	<u>\$ 1,708,766</u>	<u>\$ 497,114</u>	<u>\$ (556,472)</u>

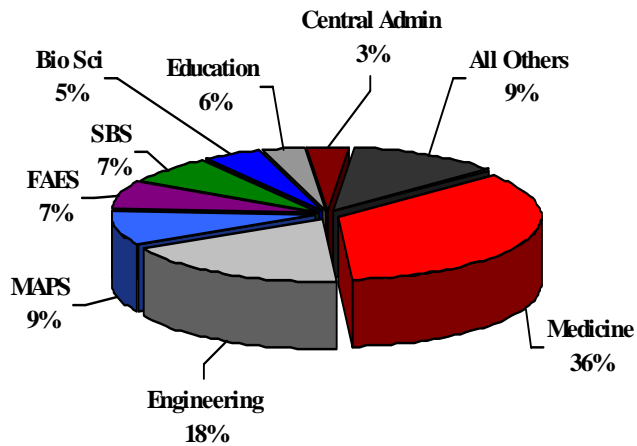
Sponsored Project Revenue/Expenses in Fiscal Year 2006 increased by \$21 million (6%) from Fiscal Year 2005. Federal sponsors generated the majority of our revenue. Our largest sponsor is the National Institutes of Health (“NIH”), accounting for 35% of our total sponsored revenue.

Revenues/Expenditures by Source Funds Fiscal Year 2006



Thirty colleges generated Sponsored Project Revenue in Fiscal Year 2006. The disciplines of Medicine and Engineering combined to generate 54% of our Sponsored Project Revenue.

Revenues / Expenditures by College Fiscal Year 2006



The University Appropriation line item represents the Research Foundation's fiscal year operating budget. The Research Foundation Administration expenditure line represents our annual expenditures against our operating budget. The difference between these two line items is our budget surplus (deficit) for the fiscal year. It is important to note that we did not overspend our cash budget this fiscal year.

Additionally, for financial statement purposes, any noncapital spending from Net Assets will flow through the income statement as Other operating expense and will therefore reduce net income. In 2006, we funded our accounts receivable collection activity and our PeopleSoft Asset Management conversion from Board Designated funds in the amount of \$156,779 which is reflected in other operating expense in the accompanying financial statements.

2005–2004 Highlights—Sponsored Project Revenue/Expenses in Fiscal Year 2005 increased by \$31 million (10%) from Fiscal Year 2004. Federal sponsors generated the majority of our revenue.

The Statement of Cash Flows

The primary source of cash receipts for operating activities consists of payments from sponsors. Cash outlays represent payments for personnel, materials, services, equipment, and travel incurred for Sponsored Research activities.

It should be noted that our corporate expenditures are carried in Cash Flows from Operating Activities and our corporate operating budget is carried in Net Cash Provided by Noncapital Financing Activities. This will usually result in a large negative cash flow from operations and a large positive cash flow from noncapital financing activities.

Net cash provided by investing activities increased by approximately \$277,000 in 2006 compared to 2005 due to higher average cash balances for the first half of the year coupled with increasing interest rates for the entire year.

Future

We believe that in Fiscal Year 2006 we reached an appropriate level of proficiency and confidence in the PeopleSoft Grants Management system. Going forward, we will leverage that proficiency by beginning to develop additional research management expertise within the college and department research support community. We will initiate a series of outreach and education opportunities that will help us build a campus-wide partnership in support of the University's research enterprise.

THE OHIO STATE UNIVERSITY RESEARCH FOUNDATION
(A Component Unit of The Ohio State University)

STATEMENTS OF NET ASSETS
AS OF JUNE 30, 2006 AND 2005

	2006	2005
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 12,994,229	\$ 20,341,002
Accounts receivable and unbilled project costs	47,245,036	54,387,642
Other receivables	<u>893,757</u>	<u>491,798</u>
Total current assets	61,133,022	75,220,442
FURNITURE AND EQUIPMENT—		
Net of accumulated depreciation of approximately \$747,702 and \$229,201 in 2006 and 2005, respectively	<u>639,373</u>	<u>817,959</u>
TOTAL	<u>\$ 61,772,395</u>	<u>\$ 76,038,401</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Accounts payable:		
Trade	\$ 7,908,117	\$ 7,497,906
The Ohio State University		590,262
Accrued payroll	1,685,790	1,992,267
Accrued vacation and sick leave	25,072	29,403
Deferred revenue—sponsors	25,468,076	33,509,960
Facilities and administrative costs payable to University departments	17,799,450	22,832,494
Designated funds for University departments	<u>405,351</u>	<u>2,786,785</u>
Total current liabilities	53,291,856	69,239,077
ACCRUED VACATION AND SICK LEAVE—Long term	<u>358,900</u>	<u>386,451</u>
Total liabilities	<u>53,650,756</u>	<u>69,625,528</u>
NET ASSETS:		
Invested in capital assets	639,373	817,959
Unrestricted	<u>7,482,266</u>	<u>5,594,914</u>
Total net assets	<u>8,121,639</u>	<u>6,412,873</u>
TOTAL	<u>\$ 61,772,395</u>	<u>\$ 76,038,401</u>

See notes to financial statements.

THE OHIO STATE UNIVERSITY RESEARCH FOUNDATION
(A Component Unit of The Ohio State University)

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

	2006	2005
OPERATING REVENUES—		
Sponsor project revenue	<u>\$ 366,960,720</u>	<u>\$ 345,776,754</u>
Total operating revenues	<u>366,960,720</u>	<u>345,776,754</u>
OPERATING EXPENSES—		
Sponsor project:		
Personnel	171,453,117	166,391,512
Materials and services	98,620,780	91,679,208
Equipment	12,598,407	9,652,710
Travel	7,701,097	6,532,025
Facilities and administrative cost charged by the University	76,587,319	71,521,299
Research administration	6,991,076	7,632,518
Depreciation	230,782	113,070
Other operating expense	<u>156,779</u>	<u> </u>
Total operating expenses	<u>374,339,357</u>	<u>353,522,342</u>
OPERATING LOSS	(7,378,637)	(7,745,588)
NONOPERATING REVENUES AND EXPENSES:		
University appropriation	8,484,820	7,917,882
Interest income—net of interest expense	<u>602,583</u>	<u>324,820</u>
INCREASE IN NET ASSETS	1,708,766	497,114
NET ASSETS—Beginning of year	<u>6,412,873</u>	<u>5,915,759</u>
NET ASSETS—End of year	<u>\$ 8,121,639</u>	<u>\$ 6,412,873</u>

See notes to financial statements.

THE OHIO STATE UNIVERSITY RESEARCH FOUNDATION
(A Component Unit of The Ohio State University)

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Received from sponsors	\$ 363,278,049	\$ 330,901,149
Payments to employees	(178,782,552)	(173,777,397)
Payments to suppliers	<u>(200,877,477)</u>	<u>(186,330,262)</u>
Net cash used in operating activities	<u>(16,381,980)</u>	<u>(29,206,510)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES—		
University appropriations	<u>8,484,820</u>	<u>7,917,882</u>
Net cash provided by noncapital financing activities	<u>8,484,820</u>	<u>7,917,882</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES—		
Purchases of furniture and equipment	<u>(52,196)</u>	<u> </u>
Net cash used in capital and related financing activities	<u>(52,196)</u>	<u> </u>
CASH FLOWS FROM INVESTING ACTIVITIES—		
Interest on cash investments	<u>602,583</u>	<u>324,820</u>
Net cash provided by investing activities	<u>602,583</u>	<u>324,820</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS	(7,346,773)	(20,963,808)
CASH AND CASH EQUIVALENTS—Beginning of year	<u>20,341,002</u>	<u>41,304,810</u>
CASH AND CASH EQUIVALENTS—End of year	<u>\$ 12,994,229</u>	<u>\$ 20,341,002</u>

(Continued)

THE OHIO STATE UNIVERSITY RESEARCH FOUNDATION
(A Component Unit of The Ohio State University)

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

	2006	2005
OPERATING ACTIVITIES:		
Operating Loss	\$ (7,378,637)	\$ (7,745,588)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation	230,782	113,070
Decrease (increase) in operating assets and increase (decrease) in operating liabilities:		
Accounts receivable and unbilled project costs	7,142,606	(10,633,677)
Other receivables	(401,959)	(232,042)
Accounts payable—trade	410,211	(4,911,876)
Accounts payable—The Ohio State University	(590,262)	(10,064,678)
Accrued payroll	(306,477)	(380,179)
Accrued vacation and sick leave	(31,882)	(304,652)
Deferred revenue—sponsors	(8,041,884)	(4,982,407)
Facilities and administrative costs payable to University departments	(5,033,044)	8,962,999
Designated funds for University departments	<u>(2,381,434)</u>	<u>972,520</u>
Net cash used in operating activities	<u>\$ (16,381,980)</u>	<u>\$ (29,206,510)</u>

See notes to financial statements.

(Concluded)

THE OHIO STATE UNIVERSITY RESEARCH FOUNDATION (A Component Unit of The Ohio State University)

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

1. ORGANIZATION

The Ohio State University Research Foundation (the “Research Foundation”), a component unit of The Ohio State University (the “University”), is a nonprofit educational corporation created in 1936 as a vehicle to promote the development, implementation, and coordination of sponsored research at the University in the furtherance of the University’s educational objectives. The Research Foundation’s financial statements and accounts are consolidated with the University’s for purposes of complying with the University’s reporting requirements.

2. ACCOUNTING POLICIES

The following is a summary of certain significant accounting policies followed in the preparation of the financial statements:

Basis of Presentation—The financial statements of the Research Foundation have been prepared on an accrual basis in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (“GASB”) including Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, and GASB Statement No. 35, *Basic Financial Statements—and Management’s Discussion and Analysis—for Public Colleges and Universities (an amendment of GASB Statement No. 34)*. The presentation required by GASB Statement No. 34 and GASB Statement No. 35 provides a comprehensive, entity-wide perspective of the Research Foundation’s assets, liabilities, net assets, revenue, expenses, and changes in net assets, and cash flows.

The Research Foundation follows all GASB pronouncements as well as Financial Accounting Standards Board (“FASB”) Statements and Interpretations, Accounting Principles Board (“APB”) Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. The Research Foundation has elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

Revenue Recognition—Substantially all of the Research Foundation’s revenues are derived from restricted grants and cost reimbursement contracts which provide for the recovery of direct and related facilities and administrative costs, subject to audit. The Research Foundation recognizes revenue associated with direct costs as the related costs are incurred. Recovery of related facilities and administrative costs is generally recorded at fixed rates negotiated with the Department of Health and Human Services, the cognizant federal audit agency.

Revenues derived from grants and contracts are reported as operating revenues. Transactions which are capital, finance, or investment-related are reported as nonoperating revenues. University appropriations and interest earned on cash investments are reported as nonoperating revenues.

Cash and Cash Equivalents—Cash and cash equivalents consist of demand deposit accounts and certificates of deposit with original maturities of less than 90 days. The Research Foundation’s cash is in the University account and is commingled with other University-related entities and invested daily in overnight investment vehicles, which are considered cash equivalents. However they are not required to be categorized under GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*. Investment income is allocated to the Research Foundation based on their ownership of the funds included in the University’s account.

At June 30, 2005, the Research Foundation also maintained a separate bank account with a bank balance of approximately \$199,000, which was uninsured by federal deposit insurance for approximately \$99,000. The uninsured balance was collateralized by pools of securities pledged by the depository bank and held in the name of the respective bank. The Research Foundation closed this account during fiscal year 2006.

Accounts Receivable and Unbilled Project Costs—Receivables are reported at their gross value when earned as the underlying exchange transaction occurs. An estimated receivable has been recorded for services rendered but not yet billed as of June 30, 2006 and 2005. The receivable was arrived at primarily by taking the subsequent payments of expenses related to cost reimbursement contracts invoiced after year-end, and recording at year-end the portions incurred and reimbursable from sponsors as of year-end.

Furniture and Equipment—Furniture and equipment are recorded at cost and the capitalization threshold is \$3,000. Provision is made for depreciation of physical properties at rates calculated to absorb costs generally over the asset’s estimated useful life of five years. Depreciation is calculated using the straight-line method. Depreciation expense was \$230,782 and \$113,070 for the years ended June 30, 2006 and 2005, respectively.

Expenditures for maintenance and repairs are charged to operating expenses as incurred; major renewals and betterments are capitalized.

	June 30, 2005	Additions	Disposal	June 30, 2006
Capital assets:				
Furniture and equipment	\$ 1,047,160	\$ 52,196	\$ 287,719	\$ 1,387,075
Less accumulated depreciation	<u>229,201</u>	<u>230,782</u>	<u>287,719</u>	<u>747,702</u>
Net capital assets	<u>\$ 817,959</u>	<u>\$ (178,586)</u>	<u>\$ -</u>	<u>\$ 639,373</u>
	June 30, 2004	Additions	Disposal	June 30, 2005
Capital assets:				
Furniture and equipment	\$ 1,061,500	\$ -	\$ (14,340)	\$ 1,047,160
Less accumulated depreciation	<u>130,471</u>	<u>113,070</u>	<u>(14,340)</u>	<u>229,201</u>
Net capital assets	<u>\$ 931,029</u>	<u>\$ (113,070)</u>	<u>\$ -</u>	<u>\$ 817,959</u>

Compensated Absences—Research Foundation employees earn vacation and sick leave on a monthly basis. Classified civil service employees may accrue vacation benefits up to a maximum of three years credit. Administrative and professional staff and faculty may accrue vacation benefits up to a maximum of 240 hours. For all classes of employees, any earned but unused vacation benefit is payable upon termination.

Sick leave may be accrued without limit. However, earned but unused sick leave benefits are payable only upon retirement from the Research Foundation with ten or more years of service with the state. The amount of sick leave benefit payable at retirement is one fourth of the value of the accrued but unused sick leave up to a maximum of 240 hours.

Activity for the years ended June 30, 2006 and 2005 are as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Compensated Absences					
2006	\$ 415,854	\$ -	\$ 31,882	\$ 383,972	\$ 25,072
2005	\$ 420,506	\$ -	\$ 4,652	\$ 415,854	\$ 29,403

In-Kind Income—The Research Foundation is a component unit of the University. As part of the relationship, transfers of funds occur between the University and the Research Foundation for certain sponsor project expenditures and research administration.

Estimates—The preparation of financial statements in conformity 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, liabilities, revenues, and expenses during the reporting period. Disclosure of contingent assets and liabilities at the date of the financial statements may also be affected. Actual results could differ from those estimates.

New Accounting Pronouncements—In April 2004, GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefits Other than Pension Plans*. The standards in this Statement apply for trust funds included in the financial reports of plan sponsors or employers, as well as for the stand-alone financial reports of other postemployment benefits (“OPEB”) plans or the public employee retirement systems, or other third parties, that administer them. The provisions of this Statement are effective for periods beginning after December 15, 2005.

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This Statement establishes standards for the measurement, recognition, and display of OPEB expense/expenditures and related liabilities (assets), note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. This Statement is effective for periods beginning after December 15, 2006.

In September 2006, GASB issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*. This Statement establishes criteria that governments will use to ascertain whether the proceeds received should be reported as revenue or as a liability. This Statement also includes guidance to be used for recognizing other assets and liabilities arising from a sale of specific receivables of future revenues, including residual interest and recourse provisions. The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2006.

In December 2006, GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. This Statement identifies the circumstances under which a governmental entity would be required to report a liability related to pollution remediation. According to the standard, a government would have to estimate its expected outlays for pollution remediation if it knows a site is polluted and various recognition triggers occur. The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2007.

The Research Foundation management has not yet determined the impact that implementation of GASB Statement Nos. 43, 45, 48, and 49 will have on the Research Foundation's financial statements.

3. DESIGNATED FUNDS FOR UNIVERSITY DEPARTMENTS

Designated funds for University departments represent unrestricted funds resulting from residual amounts from certain completed projects that are for use at the discretion of University departments and funds payable to the University from royalties held by the Research Foundation.

4. TAX-EXEMPT STATUS

The Research Foundation is exempt from federal taxes on income under Section 501(c)(3) of the Internal Revenue Code.

5. RETIREMENT PLAN

All eligible University personnel assigned to the Research Foundation are covered by the Public Employees Retirement System of Ohio ("OPERS"). Employees may opt out of OPERS and participate in the Alternative Retirement Plan ("ARP") if they meet certain eligibility requirements.

Defined Benefit Plans—OPERS offers statewide cost-sharing multiple-employer defined-benefit pension plans. OPERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. Benefits are established by state statute and are calculated using formulas that include years of service and final average salary as factors. OPERS issues a separate, publicly available financial report that includes financial statements and required supplemental information. The report may be obtained by contacting OPERS at Ohio PERS, 277 East Town Street, Columbus, OH 43215-4642, (614) 222-6701, (800) 222-PERS (7377), or www.opers.org.

In addition to the retirement benefits described above, OPERS provides postemployment health care benefits.

OPERS currently provides postemployment health care benefits to retirees with ten or more years of qualifying service credit. These benefits are advance-funded on an actuarially determined basis and are financed through employer contributions and investment earnings. OPERS determines the amount, if any, of the associated health care costs that will be absorbed by OPERS. Under Ohio Revised Code ("ORC"), funding for medical costs paid from the funds of OPERS is included in the employer contribution rate. For the fiscal year ended December 31, 2004, OPERS allocated 4.0% of the employer contribution rate to fund the health care program for retirees.

The actuarial value of assets available for these benefits at December 31, 2004 (the date of the system's latest actuarial review), was \$10.8 billion. There were 376,109 active contributing benefit recipients eligible for postemployment benefits as of December 31, 2005.

On September 9, 2004, the OPERS Retirement Board adopted a Health Care Preservation Plan (“HCPP”) with an effective date of January 1, 2007. The HCPP restructures OPERS’ health care coverage to improve the financial solvency of the fund in response to skyrocketing health care costs.

Under the HCPP, retirees eligible for health care coverage will receive a graded monthly allocation based on their years of service at retirement. HCPP incorporates a cafeteria approach, offering a broad range of health care options which allows benefit recipients to use their monthly allocation to purchase health care coverage customized to meet their individual needs. If the monthly allocation exceeds the cost of the options selected, the excess is deposited into a Retiree Medical Account that can be used to fund future health care expenses. Postemployment health care benefits are not guaranteed by ORC to be covered under OPERS.

Defined Contribution Plan—The ARP is a defined-contribution pension plan. Full-time administrative and professional staff and faculty may choose to enroll in ARP in lieu of OPERS. Classified civil service employees hired on or after August 1, 2005, are also eligible to participate in ARP. ARP does not provide disability benefits, annual cost-of-living adjustments, postretirement health care benefits, or death benefits to plan members and beneficiaries. Benefits are entirely dependent on the sum of contributions and investment returns earned by each participant’s choice of investment options.

OPERS also offers a defined-contribution plan, the Member-Directed Plan (“MD”). The MD does not provide disability benefits, annual cost-of-living adjustments, postretirement health care benefits or death benefits to plan members and beneficiaries. Benefits are entirely dependent on the sum of contributions and investment returns earned by each participant’s choice of investment options.

Combined Plans—OPERS also offers a combined plan. This is a cost-sharing multiple-employer defined-benefit plan that has elements of both a defined-benefit and defined-contribution plan. In the combined plan, employee contributions are invested in self-directed investments, and the employer contribution is used to fund a reduced defined benefit. Employees electing the combined plan receive postretirement health care benefits. OPERS provides retirement, disability, survivor, and postretirement health care benefits to qualifying members of the combined plan.

Funding Policy—ORC provides OPERS statutory authority to set employee and employer contributions. Contributions equal to those required by OPERS are required for ARP. For employees enrolling in ARP, ORC requires a portion (which may be revised pursuant to periodic actuarial studies) of the employer contribution be contributed to OPERS to enhance the stability of these plans. On January 1, 2006, the OPERS employee contribution rate increased from 8.5% to 9.0% and the employer contribution rate increased from 13.31% to 13.54%. The required contributions rates (as a percentage of covered payrolls) for plan members and the Research Foundation are as follows for 2006, 2005, and 2004:

	Employee Share	Employer Share
July 1, 2003—June 30, 2004	8.5 %	13.31 %
July 1, 2004—June 30, 2005	8.5	13.31
July 1, 2005—June 30, 2006	9.0	13.54

For the years ended June 30, 2006, 2005, and 2004 the Research Foundation reimbursed the University for the following costs for contributions associated with the retirement plans:

Years Ending	PERS	ARP
2004	\$545,948	\$ 96,395
2005	561,041	99,092
2006	576,138	100,294

6. COMMITMENTS AND CONTINGENCIES

The Research Foundation, as an associated foundation, is covered under the University's self-insurance arrangements and commercial insurance policies. The University is self-insured for employee health care benefits; and employee life, accidental death, and dismemberment benefits. Additional details regarding these self-insurance arrangements are provided in Note 6 to the University's financial statements. The University also carries commercial insurance policies for various property, casualty, and excess liability risks. Over the past three years, settlement amounts related to these insured risks have not exceeded the University's coverage amounts.

Under the terms of federal grants, periodic audits are required and certain costs may be questioned as not being appropriate expenditures under the terms of the grants. Such audits could lead to reimbursements to the grantor agencies. While questioned costs may occur, ultimate repayments required of the Research Foundation have been infrequent in prior years.

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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
The Ohio State University Research Foundation
Columbus, Ohio

We have audited the financial statements of The Ohio State University Research Foundation (the "Research Foundation") as of and for the year ended June 30, 2006, and have issued our report thereon dated December 29, 2006. 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 *Governmental Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Research Foundation's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Research Foundation'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 tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the Research Foundation in a separate letter dated December 29, 2006.

This report is intended solely for the information and use of the Board of Directors, management of the Research Foundation, federal awarding agencies, state funding agencies, pass-through entities, and the Auditor of the State of Ohio and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte + Touche LLP

December 29, 2006