

# **The Partnership for Defense Innovation**

## **Annual Report**

<b>Citation of Law or Resolution:</b>	S.L. 2011-145
<b>Section Number:</b>	Section 14.10
<b>Due Date:</b>	September 1, 2011
<b>Submission Date:</b>	October 10, 2011

### **Receiving Entities:**

The Joint Legislative Commission on Governmental Operations  
The Fiscal Research Division

### **Submitting Entity:**

The Partnership for Defense Innovation

October 9, 2011

The House of Representatives Appropriation Subcommittee on Natural and Economic Resources  
The Senate Appropriation Subcommittee on Natural and Economic Resources  
The Joint Legislative Commission on Governmental Operations  
The Fiscal Research Division

To Whom It May Concern,

The Partnership for Defense Innovation would like to present the following report on the activities and accomplishments during the year 2010/2011. We are proud of the recruitment of our clients and the sustainment of the program. We are also very proud of the three companies that have graduated the program and also the grants we were able to give out this year to help small business reach a research goal for their products.

The attached financials are a draft report from our accountants, Cherry Baekart and Holland. These reports will be finalized as of November after final review. We are proud to say that the audit had found no discrepancies or weaknesses.

If you have any questions, please call me at 910-307-3000.

Thank you,

R. Scott Perry  
President PDI



## Board of Directors FY10

**Bobby J. Ervin, Chair**

Vice President for Learning Technologies  
Fayetteville Technical Community College

**Lynne Greene, Treasurer**

Vice President, Highland Lumber Co., Inc.

**John Tuohey**

Director of Operations, Sierra Nevada Corp.

**COL James Lien, US Army (Ret)**

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**Tim Richardson**

Area Vice President, First Citizens Bank

**Dennis Kekas, Vice Chairman**

NCSU Networking Technology Institute

**Larry Robbins, Secretary**

Wyrick Robbins Yates & Ponton LLP

**Larry Walsh**

President, The Logistics Company

**Emily M. Dickens, Esq.**

Director of Community and Government Affairs  
Fayetteville State University

**Bob McMahon**

Dean, Kimmel School at Western Carolina Univ.

## Ex-Officio Members

**Doug Peters**

President  
Fayetteville Cumberland County Chamber

**R. Scott Perry**

President, PDI  
Executive Director, DSTA

**Brooks Raiford**

President & CEO  
North Carolina Technology Association



## **PDI Advisory Board Members**

### **The Honorable Robin Hayes**

Former Republican Congressman  
Represented North Carolina's 8<sup>th</sup> Congressional  
district in the House of Representatives

### **The Honorable Duncan Hunter**

Former Republican member of the House of  
Representatives; represented California's 52<sup>nd</sup>,  
45<sup>th</sup> and 42<sup>nd</sup> districts

### **Major General (ret) Gary Harrell**

Former Commanding General of the U.S. Army  
Special Operations Command (USASOC)

### **Major General (ret) James Parker**

Former Commanding General of the JFK Special  
Warfare Center and School

### **Edward Carney**

Vice President and General Manager  
Advanced Services Customer Advocacy  
Cisco Systems, Inc.

### **Paul Zeisman**

Vice President Tactical Communications  
Sierra Nevada Corporation

### **Kimrey Rhinehardt**

Vice President Federal Relations  
University of North Carolina,  
General Administration

### **Mike Bordone**

Vice President Wealth Management  
Merrill Lynch, Pierce, Fenner & Smith Inc.

## PDI Summary Reports of Activities for FY 2010

**State Funding Received to Date: \$7.04M**

**Federal Funding Received to Date: \$7.4M**

**PDI Employees: 16**

### Programs of PDI:

- Defense & Security Technology Accelerator (DSTA)
- PDI Research & Development (R&D) Lab

### DSTA Clients:

- **\$30M** small business economic infusion
- **150** jobs created YTD
- Clients recruited during FY11: **5**
- Clients recruited to date: **39**
- DSTA Graduate Companies to date: **3**

### DSTA Client Services:

- Turn-Key Business Offices
- 86 point Client Management Plan
- Grant funding & financing
  - **\$50K** PDI Fusion Grant
  - **\$75K** Rural Business Enterprise Grant (RBEG) Revolving Loan Program
  - **\$800K** Golden Leaf Capital Equipment Loan (Pending)
- Technology Commercialization
  - NCSU Engineering Support
  - NCSU Ergonomics Study
  - NC Based Manufacturers
  - Western Carolina University Prototype Lab Developer
- Collaboration with Academia

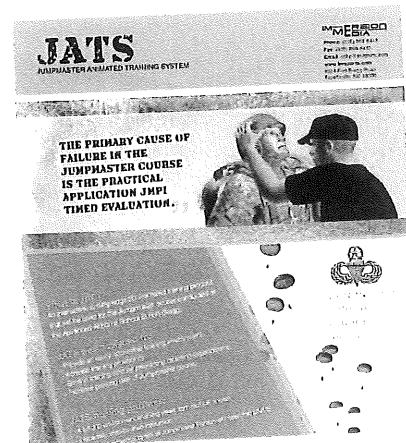


**PDI Headquarters- Fayetteville, NC**



**GEN Wagner observing DSTA client Mobile Tower Technology's 150ft Rapid Deployment Tower**

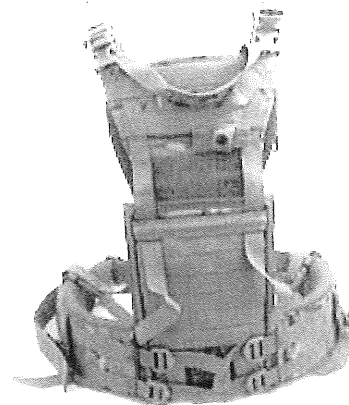
- Tradeshow Presence & Client Representation
  - Association of the United States Army (AUSA) Annual Meeting
  - Special Operations Forces Symposium & Expo (SOFEX)
  - Special Operations Forces Industry Conference (SOFIC)
- Subject Matter Expert (SME) Training to include:
  - Shipley Training-Federal Contract Certification
  - WAWF (Wide Area Work Flow)
  - GSA (General Service Administration)
  - Total # of group training events offered during FY11: **12**
- PDI Call for Technologies Competition, April 19-20, 2011
  - Investing in small businesses across NC with defense technologies
  - **\$25K** in Fusion Grant Awards with **\$7K** worth of DSTA client program services
  - Collaboration with the North Carolina Defense Business Association (NCDBA) Contractor Symposium and Exposition



**Jumpmaster Animated Training System (JATS) created by DSTA client & \$44K PDI Fusion Grant Recipient, Immersion Media**

#### **Key Successes:**

- **K3 Enterprises, Inc.**
  - First DSTA Client Graduate Company (FY08)
  - Created **47 jobs** (grew from 3 to 50 employees as DSTA client)
  - Purchased 50,000 square foot building in Fayetteville, NC
- **Mobile Tower Technology**
  - Production Ready Company (FY09)
  - Received Engineering Support for Tower Project
- **Immersion Media**
  - DSTA Client Graduate Company (FY10)
  - **\$44K** PDI Fusion Grant Awarded
  - Created Jumpmaster Training Product for the Advanced Airborne School at Fort Bragg
- **Archangel Armor**
  - **\$1.1M** developmental contract awarded while in DSTA program
  - Commercialization of product while in DSTA program
  - Received Ergonomics Study of product from NCSU
- **Llevron Logistics**
  - **\$545K** in contracts, in first four (4) months of DSTA program
  - Moved to Cumberland County from Gaston County



**\$1.1M DoD developmental contract to develop The Internal Front Load Body Armor (IFLBA) created by DSTA client Archangel Armor**

### PDI R&D Lab:

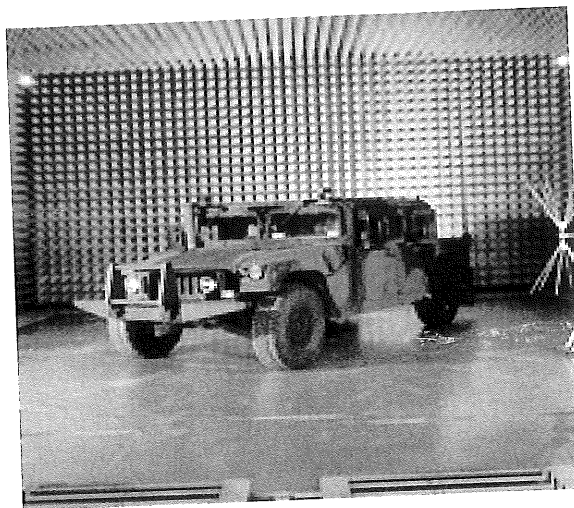
- Federal Funding: **\$7.4M (\$2.8M FY11)**
- Anchor Tenant in All American Military Business Park
- **\$2.8M** Facility
- **\$1.3M** in Industrial R&D Environmental and Emissions Testing Equipment
- Aimed at keeping jobs and government contracts in North Carolina
- Employees recruited from Lockheed NASA Program, US Navy, Sprint Nextel, and Ericson Services
- Average employee salary of **\$76K**

### Lab Capabilities:

- **Support and Engineering Services**
  - Operations Support
  - IT/Network Support
  - Wireless Spectrum Analysis
  - End User Security Training
  - System Integration
  - Network Engineering
- **Environmental Testing**
  - Vertical Air-to-Air Thermal Shock Chamber
  - Temperature Humidity Chamber
  - Temperature Altitude Chamber
- **EMC Compliance Testing**
  - Semi-Anechoic Chamber (36'L x 36'W x 18'H)
    - MIL-STD 461 Testing
    - MIL-STD 810 Testing



10,000 sq. ft. PDI R&D Lab



PDI R&D Lab Semi-Anechoic Chamber

**PARTNERSHIP FOR DEFENSE INNOVATION**  
Fayetteville, North Carolina

**Financial Statements**

Years Ended June 30, 2011 and 2010



PARTNERSHIP FOR DEFENSE INNOVATION

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**REPORT OF INDEPENDENT AUDITORS**

## **REPORT OF INDEPENDENT AUDITORS**

Board of Directors  
Partnership for Defense Innovation  
Fayetteville, North Carolina

We have audited the accompanying statements of financial position of the Partnership for Defense Innovation (PDI) as of June 30, 2011 and 2010, and the related statements of activities, functional expenses and cash flows for the years then ended. These financial statements are the responsibility of PDI'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 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and 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 opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of PDI as of June 30, 2011 and 2010, 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 16, 2011 on our consideration of PDI's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying schedule of expenditures of Federal and State awards for the year ended June 30, 2011 as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, North Carolina General Statutes Sec. 143C-6-23 is presented for purposes of additional analysis and is not a required part of the basic 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 financial statements as a whole.

**CHERRY, BEKAERT & HOLLAND, L.L.P.**

Raleigh, North Carolina  
November 16, 2011

Partnership for Defense Innovation  
Statement of Financial Position  
June 30, 2011 and 2010

	2011			2010		
	Unrestricted	Temporarily Restricted	Total	Unrestricted	Temporarily Restricted	Total
<b>Current Assets</b>						
Cash	\$ 648,837	\$ 37,708	\$ 686,545	\$ 850,326	\$ -	\$ 850,326
Accounts receivable	276,115	-	276,115	224,770	-	224,770
Prepaid expenses	8,422	-	8,422	3,467	-	3,467
<b>Total current assets</b>	<b>933,374</b>	<b>37,708</b>	<b>971,082</b>	<b>1,078,563</b>	<b>-</b>	<b>1,078,563</b>
<b>Noncurrent assets</b>						
Property and equipment, net	504,741	-	504,741	558,131	-	558,131
Other noncurrent assets	128,510	-	128,510	54,072	-	54,072
<b>Total noncurrent assets</b>	<b>633,251</b>	<b>-</b>	<b>633,251</b>	<b>612,203</b>	<b>-</b>	<b>612,203</b>
<b>Total assets</b>	<b>\$ 1,566,625</b>	<b>\$ 37,708</b>	<b>\$ 1,604,333</b>	<b>\$ 1,690,766</b>	<b>\$ -</b>	<b>\$ 1,690,766</b>
<b>Current liabilities</b>						
Current portion of long-term liabilities	\$ 3,200	\$ -	\$ 3,200	\$ 600	\$ -	\$ 600
Accounts payable	222,898	-	222,898	454,930	-	454,930
Unearned revenues	1,600	-	1,600	-	-	-
Accrued vacation	13,089	-	13,089	10,036	-	10,036
Security deposits payable	13,201	-	13,201	7,404	-	7,404
<b>Total current liabilities</b>	<b>253,988</b>	<b>-</b>	<b>253,988</b>	<b>472,970</b>	<b>-</b>	<b>472,970</b>
<b>Long-term Liabilities</b>						
Capital lease obligation, net of current portion	7,408	-	7,408	-	-	-
<b>Total liabilities</b>	<b>261,396</b>	<b>-</b>	<b>261,396</b>	<b>472,970</b>	<b>-</b>	<b>472,970</b>
<b>Net Assets</b>	<b>1,305,229</b>	<b>37,708</b>	<b>1,342,937</b>	<b>1,217,796</b>	<b>-</b>	<b>1,217,796</b>
<b>Total liabilities and net assets</b>	<b>\$ 1,566,625</b>	<b>\$ 37,708</b>	<b>\$ 1,604,333</b>	<b>\$ 1,690,766</b>	<b>\$ -</b>	<b>\$ 1,690,766</b>

The accompanying notes are an integral part of these financial statements.

Partnership for Defense Innovation  
Statement of Activities  
Years Ended June 30, 2011 and 2010

	2011			2010		
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
<b>Public support and other revenue:</b>						
Public support:						
State grants	\$ -	\$ 916,750	\$ 916,750	\$ -	\$ 950,000	\$ 950,000
Federal grants	-	75,000	75,000	-	-	-
Capital Campaign and other contribution	6,250	-	6,250	5,000	-	5,000
Total public support	6,250	991,750	998,000	5,000	950,000	955,000
Other Revenues						
Interest income	330	-	330	16	-	16
Rental income	152,065	-	152,065	115,118	-	115,118
Affiliate income	52,900	-	52,900	35,800	-	35,800
Contract income	2,130,539	-	2,130,539	2,569,848	-	2,569,848
Other income	13,135	-	13,135	11,900	-	11,900
Total other revenue	2,348,969	-	2,348,969	2,732,682	-	2,732,682
Total public support and other revenue	2,355,219	991,750	3,346,969	2,737,682	950,000	3,687,682
<b>Expenses:</b>						
Program Service - DSTA	1,298,366	-	1,298,366	1,438,960	-	1,438,960
Program Service - Lab	1,837,855	-	1,837,855	2,230,950	-	2,230,950
Management and general	85,607	-	85,607	111,058	-	111,058
Total expenses	3,221,828	-	3,221,828	3,780,968	-	3,780,968
<b>Net assets released from restrictions</b>	954,042	(954,042)	-	1,400,673	(1,400,673)	-
<b>Change in net assets</b>	87,433	37,708	125,141	357,387	(450,673)	(93,286)
<b>Net assets, beginning of year</b>	1,217,796	-	1,217,796	860,409	450,673	1,311,082
<b>Net assets, end of year</b>	\$ 1,305,229	\$ 37,708	\$ 1,342,937	\$ 1,217,796	\$ -	\$ 1,217,796

The accompanying notes are an integral part of these financial statements.

Partnership for Defense Innovation  
Statement of Functional Expenses  
Years Ended June 30, 2011 and 2010

	2011				2010			
	Program Service - DSTA	Program Service - Lab	Management and General	Total	Program Service - DSTA	Program Service - Lab	Management and General	Total
Salaries, benefits, payroll taxes and fees	\$ 751,794	\$ 838,658	\$ -	\$ 1,590,452	\$ 857,852	\$ 165,574	\$ -	\$ 1,023,426
Occupancy	258,766	160,529	-	419,295	264,832	-	-	264,832
Professional fees	105,964	42,108	-	148,072	133,766	-	-	133,766
Fusion grant	14,623	-	-	14,623	41,908	-	-	41,908
Marketing	1,351	29,242	-	30,593	1,838	-	-	1,838
Insurance	5,586	1,636	-	7,222	5,954	-	-	5,954
Dues and subscriptions	16,354	671	-	17,025	10,213	45	-	10,258
Supplies	19,070	4,825	-	23,895	17,933	-	-	17,933
Subcontractors	-	345,109	-	345,109	-	1,087,098	-	1,087,098
Materials	-	349,843	-	349,843	-	954,742	-	954,742
Postage	1,443	42	-	1,485	1,200	-	-	1,200
Printing	1,434	388	-	1,822	3,949	-	-	3,949
Telephone and internet	28,697	30,131	-	58,828	33,550	13,800	-	47,350
Travel and meetings	74,372	27,952	-	102,324	55,969	4,371	-	60,340
Interest	-	-	-	-	-	-	23,717	23,717
Bank charges	-	-	4,217	4,217	-	-	7,640	7,640
Depreciation	-	-	71,437	71,437	-	-	68,950	68,950
Equipment rental and maintenance	17,776	6,577	-	24,353	9,646	1,320	-	10,966
Bad debt expense	-	-	1,500	1,500	-	-	6,661	6,661
Miscellaneous	1,136	144	8,453	9,733	350	4,000	4,090	8,440
Total Expenses	\$ 1,298,366	\$ 1,837,855	\$ 85,607	\$ 3,221,828	\$ 1,438,960	\$ 2,230,950	\$ 111,058	\$ 3,780,968

The accompanying notes are an integral part of these financial statements.

Partnership for Defense Innovation  
Statements of Cash Flows  
Years Ended June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
<b>Cash flows from operating activities</b>		
Changes in net assets	\$ 125,141	\$ (93,286)
Adjustments to reconcile changes in net assets to net cash used in operating activities		
Depreciation	71,437	68,950
Changes in assets and liabilities:		
Accounts receivable	(51,345)	669,579
Prepaid expenses	(4,955)	(34)
Inventory	-	385
Other assets	562	-
Accounts payable	(232,032)	63,746
Unearned affiliate fees	1,600	(1,200)
Accrued expenses	3,053	(1,828)
Security deposits payable	5,797	(1,861)
Net cash provided/(used) by operating activities	<u>(80,742)</u>	<u>704,451</u>
<b>Cash flows from financing activities</b>		
Proceeds from capital lease	12,971	-
Repayment of capital lease	(2,964)	(1,460)
Net cash provided/(used) by financing activities	<u>10,007</u>	<u>(1,460)</u>
<b>Cash flows from investing activities</b>		
Note receivable issued--Revolving Loan Program	(75,000)	-
Acquisition of property and equipment	(18,046)	(2,694)
Net cash used by investing activities	<u>(93,046)</u>	<u>(2,694)</u>
<b>Net increase (decrease) in cash</b>	<u>(163,781)</u>	<u>700,297</u>
<b>Cash</b>		
Beginning of year	<u>850,326</u>	<u>150,029</u>
End of year	<u>\$ 686,545</u>	<u>\$ 850,326</u>

The accompanying notes are an integral part of these financial statements.

PARTNERSHIP FOR DEFENSE INNOVATION  
NOTES TO FINANCIAL STATEMENTS  
Years Ended June 30, 2011 and 2010

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**Note 1 – NATURE OF ACTIVITIES AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Nature of activities

Partnership for Defense Innovation (PDI) is a North Carolina not-for-profit organization created to promote economic development, job creation, research and development, and education with respect to technologies having applications in defense and homeland security and for the benefit and support of economic development in the City of Fayetteville and Cumberland County, North Carolina. PDI accomplishes these purposes by maintaining an incubator facility for companies in North Carolina engaged in the research and development of technologies associated with military and homeland security as well as operating and maintaining advanced laboratory facilities in Fayetteville, North Carolina for conducting research and development testing of technologies having defense and security applications. PDI supports research, development, education and programs with applications in defense and security and collaborates with educational institutions, the military/intelligence community, the State of North Carolina, the Federal government and other private institutions. PDI earns revenues by receiving charitable donations and grant and contract agreements from federal and state governments and by charging clients for services, including laboratory research and rent.

Summary of Significant Accounting Policies

The significant accounting policies of PDI are summarized below:

Basis of Reporting and Accounting

The financial statements are presented following recommendations of Accounting Standards Codification ("ASC") 958 Not-for-Profit Entities. Under ASC 958, PDI is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets. PDI does not have any permanently restricted net assets. PDI follows the accrual basis of accounting, whereby revenues are recognized when earned and expenses are recognized when incurred. This basis conforms to accounting principles generally accepted in the United States of America.

Public Support and Revenue

Contributions, grants and contract revenues are generally available for unrestricted use unless specifically restricted by the donor. Unconditional promises to give are recorded as received. Unconditional promises to give due in the next year are reflected as current promises to give and are recorded at their net realizable value.

Grants, contracts and other contributions of cash and other assets are reported as temporarily restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

Restricted Cash

The portion of State grant funding not expended during the year is reported as restricted cash.



PARTNERSHIP FOR DEFENSE INNOVATION  
**NOTES TO FINANCIAL STATEMENTS**  
Years Ended June 30, 2011 and 2010

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**Note 1 – NATURE OF ACTIVITIES AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**  
**(continued)**

Cash Equivalents

For purposes of the statement of cash flows, PDI considers all highly liquid investments available for current use with an initial maturity of three months or less to be cash equivalents. At June 30, 2011 and 2010, PDI's cash consisted of demand deposits.

Accounts receivable

Accounts receivable are primarily generated from prime contracts with U.S. governmental agencies and include billed amounts, which represent invoices that have been prepared and sent to the customer, and unbilled receivables, which consist of administrative timing differences (costs that were billed subsequent to year end). Other accounts receivable are stated at amounts billed to clients. Credit is generally extended on a short-term basis, thus trade receivables generally do not bear interest. Rent accounts receivable are periodically evaluated for collectability and are considered past due after 10 days, when they become subject to a late charge of four percent. Accounts receivable generated from grants and pledges represent amounts awarded or promised but not yet paid.

These amounts are presented net of an allowance for doubtful accounts.

On January 8, 2010, PDI entered into an accounts receivable factoring arrangement with First Citizens Bank to provide for the accelerated receipt of cash on eligible accounts receivable at PDI's discretion. Under the current terms of the agreement, the maximum balance at any given time will not exceed \$500,000. As of June 30, 2011 and 2010, the outstanding balance was \$0.

Revenue recognition

Revenue from cost-type contracts is recognized as costs are incurred on the basis of direct costs and a proportionate portion of fee for those cost-type contracts which also include a fee. Revenues on fixed-price contracts are recognized on the basis of costs incurred to date and a portion of the fee included in the contract price, approximating the percentage-of-completion method of accounting based upon costs to date compared to total estimated costs.

Allowance for doubtful accounts

An allowance for doubtful accounts is maintained on all types of receivables. Management's determination of the allowance for doubtful accounts is based on an evaluation of the accounts receivable, historical collection experience, current aging of amounts due, and specific evaluations of the collectability of individual balances. Estimates for uncollectible accounts are reported in the period during which the services are provided even though the actual amounts may become known at a later date. No allowance was considered necessary as of June 30, 2011 or 2010.

PARTNERSHIP FOR DEFENSE INNOVATION  
NOTES TO FINANCIAL STATEMENTS  
Years Ended June 30, 2011 and 2010

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**Note 1 – NATURE OF ACTIVITIES AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES  
(continued)**

Property and equipment

Property and equipment with an initial, individual cost of more than \$1,000 are recorded at cost, and depreciation is calculated using the straight-line method over the following estimated useful lives:

<u>Asset Category</u>	<u>Useful Life</u>
Furniture and equipment	5-10 years
Leasehold improvements	15 years

Other assets

Other assets include security deposits on leased office space, a deposit with the payroll processor and a note receivable.

During 2011, PDI received a grant from the US Department of Agriculture for the purpose of establishing a revolving loan fund to promote the economic development of the State of North Carolina by encouraging firms to locate, expand or retain facilities in designated Tier I counties and economically distressed towns. The primary manner of promoting development is by making available loans, normally of a short-term basis, at interest rates below those offered in the commercial market, and/or deferred loan repayments to qualifying firms. Under this new revolving loan program, PDI loaned \$75,000 to a North Carolina company. The loan bears interest at the *Wall Street Journal* prime rate plus 2%. Interest is payable monthly through April 2012, followed by monthly payments of principal and interest until maturity in April 2015. The loan is secured by the personal guarantees of two owners of the company.

Net Assets

Net assets of PDI and changes therein are classified and reported as follows:

Unrestricted Net Assets – include those net assets whose use is not restricted by donors or grantors, even though their use may be limited in other respects, such as by board designation.

Temporarily Restricted Net Assets – include those net assets whose use by PDI has been donor or grantor restricted by specified time or purpose limitations. See Note 5 for details of temporarily restricted net assets.

Advertising costs

The cost of advertising is expensed as incurred. PDI incurred advertising costs of \$30,563 and \$0 in 2011 and 2010, respectively.

PARTNERSHIP FOR DEFENSE INNOVATION  
**NOTES TO FINANCIAL STATEMENTS**  
Years Ended June 30, 2011 and 2010

**Note 1 – NATURE OF ACTIVITIES AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**  
**(continued)**

Income Taxes

PDI is exempt from income tax under Section 501(c)(3) of the Internal Revenue Code. Management has evaluated the effect of the guidance provided by U S Generally Accepted Accounting Principles on Accounting for Uncertainty in Income Taxes. Management believes that PDI continues to satisfy the requirements of a tax-exempt organization at June 30, 2011. Management has evaluated all other tax positions that could have a significant effect on the financial statements and determined PDI had no uncertain income tax positions at June 30, 2011.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the use of management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

**Note 2 – ACCOUNTS RECEIVABLE**

Accounts receivable at June 30, 2011 and 2010 consisted of:

	2011	2010
Accounts Receivable	\$ 1,005	\$ 2,370
Contract Receivable (billed)	61,807	122,614
Contract Receivable (unbilled)	213,303	99,786
	<u>\$ 276,115</u>	<u>\$ 224,770</u>

Accounts receivable at June 30, 2011 and 2010 are rent receivable from tenants and fees receivable from nonresident clients. PDI leases office space to unrelated subtenants who are in the business of defense security and technology. PDI assists nonresident companies with developing new business and technologies related to defense security and technology. The contract receivable consists of amounts due primarily from the United States Department of Defense.

**Note 3 – PROPERTY AND EQUIPMENT**

Property and equipment at June 30, 2011 and 2010 consisted of:

	2011	2010
Furniture and equipment	\$ 284,426	\$ 270,732
Leasehold improvements	532,839	528,487
	<u>817,265</u>	<u>799,219</u>
Less accumulated depreciation	312,524	241,088
	<u>\$ 504,741</u>	<u>\$ 558,131</u>

Depreciation expense was \$71,437 and \$68,950 for the years ended June 30, 2011 and 2010, respectively, and includes amortization of assets under capital leases.

Included in property and equipment are assets acquired under capital lease in the amount of \$18,500 with accumulated depreciation of \$7,014.

PARTNERSHIP FOR DEFENSE INNOVATION  
**NOTES TO FINANCIAL STATEMENTS**  
Years Ended June 30, 2011 and 2010

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**Note 4 – CONCENTRATIONS OF CREDIT RISK**

PDI places its cash and cash equivalents on deposit with financial institutions in the United States. The Federal Deposit Insurance Corporation (FDIC) covers \$250,000 for substantially all depository accounts and temporarily provides unlimited coverage through December 31, 2012 for certain qualifying and participating non-interest bearing transaction accounts. PDI from time to time may have amounts on deposit in excess of the insured limits. As of June 30, 2011, PDI had \$0 which exceeded these insured amounts.

PDI's primary business during 2011 and 2010 was the operation of a defense technology innovation center and testing lab. During 2011 and 2010, PDI received state grants to help fund these operations. These grants represented approximately 27% and 26% of total revenue and support for 2011 and 2010, respectively.

Receivables due from U.S. Government agencies represent 99% and 99% of the accounts receivable balance at June 30, 2011 and 2010, respectively. Additionally, revenues produced by contracts with U.S. Government agencies accounted for approximately 63% and 70% of total revenues for the years ended June 30, 2011 and 2010, respectively.

**Note 5 – RESTRICTED NET ASSETS**

At June 30, 2011 and 2010, temporarily restricted net assets are available primarily for the operation of a defense technology innovation center and testing lab. During 2011 and 2010, PDI utilized \$954,042 and \$1,400,673, respectively, in proceeds from temporarily restricted donations for their intended purposes.

**Note 6 – CONTINGENCIES**

PDI has received federal and state contracts and awards for specific purposes that are subject to review and closeout audits by the agencies. Such audits could lead to a request for reimbursement by the awarding agency for expenditures disallowed under terms of the contract or award. Management believes such disallowances, if any, would not be material to the financial statements of PDI.

Since a portion of PDI's revenue is derived from contracts with the U.S. government, any cancellations or modifications of significant contracts or subcontracts, or failure by the U.S. government to exercise an option period relating to those contracts or subcontracts, could adversely affect the financial condition and results of operations in the short and long term. Additionally, U.S. government contracts can be terminated at any time by the U.S. government without cause, for the convenience of the U.S. government. If such termination occurs, PDI would be entitled to receive compensation for services provided and costs incurred through termination, plus a negotiated amount of profit.

PDI has cost reimbursable type contracts with the Federal Government. Consequently, PDI is reimbursed based on its direct expenses attributable to the contract. Contract expenses and billings are subject to audit by the Defense Contract Audit Agency (DCAA) or other appropriate government agency.

PARTNERSHIP FOR DEFENSE INNOVATION  
NOTES TO FINANCIAL STATEMENTS  
Years Ended June 30, 2011 and 2010

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**Note 6 – CONTINGENCIES (continued)**

The Government Accountability Office (“GAO”) and the Defense Contract Audit Agency (“DCAA”) are entitled to review PDI’s accounting and other records. The GAO is responsible for determining that procurement actions are made in conformity with applicable laws and regulations. The DCAA is primarily responsible for determining the acceptability of estimated or incurred costs as allowable contract costs. Payments to PDI on cost reimbursable contracts are provisional and are subject to adjustment upon audit by the DCAA. PDI has not yet been audited. In the opinion of management, audit adjustments that may result from such audits are not expected to have a material effect on PDI’s financial position, results of operations, or cash flows.

**Note 7 – LEASE COMMITMENTS**

Beginning in fiscal year 2008, PDI operated additional offices in Charlotte and Raleigh, North Carolina. PDI leases its office facilities from unrelated parties. Rent expense was \$201,750 and \$201,750 for the Fayetteville headquarters, \$3,688 and \$8,250 for the Charlotte office, and \$6,160 and \$6,160 for the Raleigh office, for 2011 and 2010, respectively. A lease extension has been signed for the 455 Ramsey St. PDI headquarter facility, giving PDI a five-year renewal option at rates approximating fair rental value at the time of renewal with an availability to terminate at eighteen months upon acquisition of another location in the Military Business Park or when State funding for the DSTA program is no longer available. The Raleigh lease provides one-year renewal options. The Charlotte office was closed in 2011.

In fiscal year 2010, PDI entered into a lease agreement to secure space for the PDI Research and Development Laboratory in Fayetteville, North Carolina. The lease has an initial term of 10 years with a total commitment of \$2,044,312 and two 5-year option periods. Occupancy of the facility began November 1, 2010. Rent expense, which was \$136,280 for 2011, is a direct cost of a current contract with the US Department of Defense with a period of performance ending in September 2013.

Minimum future rental expense commitments are:

	Fayetteville
2012	\$ 410,298
2013	406,170
2014	406,170
2015	406,170
2016	271,670
2017	204,420
2018	204,420
2019	204,420
2020	204,420
2021	68,250
	<u>\$ 2,786,408</u>

PDI subleases portions of its facilities to its clients under sublease agreements on a month-to-month basis. The sublease payments include specific office space, use of common areas like conference rooms, and utilities. For the years ended June 30, 2011 and 2010, rental income totaled \$152,065 and \$115,118, respectively.

PARTNERSHIP FOR DEFENSE INNOVATION  
**NOTES TO FINANCIAL STATEMENTS**  
Years Ended June 30, 2011 and 2010

**Note 8 – DEFINED CONTRIBUTION PLAN**

During 2008, PDI established a 401(k) plan that covers all employees immediately upon hire. PDI does not make any contributions to the plan.

**Note 9 – COMPENSATED ABSENCES**

PDI's vacation policy, effective July 1, 2008, allows employees to carry over up to 40 hours of unused vacation time to the next year on a calendar year basis. In addition, barring certain restrictions, an employee may be paid for unused vacation hours at termination. PDI estimates the liability for vacation pay at June 30, 2011 and 2010 to be \$13,089 and \$10,036, respectively.

**Note 10 – OTHER COMMITMENTS**

On March 29, 2011, PDI entered into a subcontract agreement with SyTech Corporation for services related to the PDI DOD contract for a fixed fee price of \$978,571. As of June 30, 2011, \$723,481 remained to be billed as per contract.

**Note 11 – LONG-TERM LIABILITIES**

Long-term liabilities at June 30, 2011 and 2010 consisted of the following:

	2011	2010
Obligations under capital lease		
CIT Technology Financing Services, \$128 monthly plus any applicable charges, through fiscal year 2011	\$ -	\$ 600
De Lage Landen Financial Services, \$280 monthly plus any applicable charges, through fiscal year 2015	10,608	-
	10,608	600
Less current portion	3,200	600
Long-term portion	<u>\$ 7,408</u>	<u>\$ -</u>

Maturities of long-term liabilities are as follows:

2012	\$ 3,200
2013	3,256
2014	3,314
2015	838
	<u>\$ 10,608</u>

PARTNERSHIP FOR DEFENSE INNOVATION  
**NOTES TO FINANCIAL STATEMENTS**  
Years Ended June 30, 2011 and 2010

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**Note 11 – LONG-TERM LIABILITIES (continued)**

Future minimum lease payments under capitalized leases together with the present value (outstanding principal) of the net minimum payments as of June 30, 2011, follows:

2012	\$ 3,360
2013	3,360
2014	3,360
2015	840
	<u>10,920</u>
Less – amount representing interest (1.75% at June 30, 2011)	312
Present value of net minimum lease payments	<u>\$ 10,608</u>

**Note 12 – LINE OF CREDIT**

During 2011, PDI obtained a \$150,000 revolving bank line of credit, which matures in May 2012. The outstanding balance at June 30, 2011 was \$0. The interest rate is at the *Wall Street Journal* prime rate (3.25% at June 30, 2011), with a floor of 4.25% and a ceiling of the lower of 8.25% or maximum allowed by law. The note is unsecured.

**Note 13 – SUBSEQUENT EVENTS**

PDI has evaluated subsequent events through November 16, 2011 in connection with the preparation of these financial statements which is the date the financial statements were available to be issued.

**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**

Board of Directors  
Partnership for Defense Innovation  
Fayetteville, North Carolina

We have audited the accompanying financial statements of Partnership for Defense Innovation (PDI) as of and for the years ended June 30, 2011 and 2010, and have issued our report thereon dated November 16, 2011. 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.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered PDI's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of PDI's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of PDI's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.



### Compliance and Other Matters

As part of obtaining reasonable assurance about whether PDI'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 or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Directors, others within the entity, and Federal and State awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

**CHERRY, BEKAERT & HOLLAND, L.L.P.**

Raleigh, North Carolina  
November 16, 2011

PARTNERSHIP FOR DEFENSE INNOVATION  
**SCHEDULE OF FINDINGS AND RESPONSES**  
Year Ended June 30, 2011

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**Section I – Summary of Auditors’ Results**

*Financial Statements*

Type of auditors’ report issued: *Unqualified*

Internal control over financial reporting:

- Material weakness(es) identified \_\_\_\_\_ yes   X   no
- Significant deficiency(s) identified that are not considered to be material weaknesses \_\_\_\_\_ yes   X   none reported
- Noncompliance material to financial statements noted \_\_\_\_\_ yes   X   no

**Section II – Financial Statement Findings**

None reported

PARTNERSHIP FOR DEFENSE INNOVATION  
**SCHEDULE OF PRIOR AUDIT FINDINGS**  
Year Ended June 30, 2011

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**FINDING:** 10-01

**STATUS:** Completed

PARTNERSHIP FOR DEFENSE INNOVATION  
**SCHEDULE OF EXPENDITURES OF FEDERAL AND STATE AWARDS**  
Year Ended June 30, 2011

<u>GRANTOR/PASS-THROUGH Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>State Grantor's Number</u>	<u>Federal (Direct &amp; Pass-through) Expenditures</u>	<u>State Receipts</u>	<u>State Expenditures</u>
<b><u>US DEPARTMENT OF AGRICULTURE</u></b>					
Rural Development					
Rural Business Enterprise Grants	10.769		\$ 75,000	\$ -	\$ -
<b><u>NC DEPARTMENT OF COMMERCE</u></b>					
Fiscal Management Division					
Defense and Security Technology Accelerator		G20431000911DEF	-	916,750	879,042
			<u>\$ 75,000</u>	<u>\$ 916,750</u>	<u>\$ 879,042</u>

**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AND STATE AWARDS:**

1. The accompanying schedule of expenditures of Federal and State awards includes the State grant activity of Partnership for Defense Innovation, and is presented on the cash basis of accounting which is the basis PDI uses for reporting expenditures to the State throughout the year. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in, the preparation of the financial statements.