

# Research Triangle Institute

Consolidated Financial Statements as of and for  
the Years Ended September 30, 2020 and 2019,  
Federal Awards Supplemental Information as of  
and for the Year Ended September 30, 2020, and  
Independent Auditors' Report

# RESEARCH TRIANGLE INSTITUTE

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## INDEPENDENT AUDITORS' REPORT

To the Board of Governors  
Research Triangle Institute:

### Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Research Triangle Institute and its subsidiaries (the "Institute"), which comprise the consolidated balance sheets as of September 30, 2020 and 2019, and the related consolidated statements of revenue, costs, and changes in net assets and of cash flows for the years then ended, and the related notes to the consolidated financial statements.

### Management's Responsibility for the Consolidated Financial Statements

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

### Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free from material misstatement.

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

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

## Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Institute as of September 30, 2020 and 2019, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

## Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report, dated December 10, 2020, on our consideration of the Institute's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Institute's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Institute's internal control over financial reporting and compliance.

The image shows a handwritten signature in black ink that reads "Deloitte & Touche LLP". The signature is written in a cursive, flowing style.

December 10, 2020

# RESEARCH TRIANGLE INSTITUTE

## CONSOLIDATED BALANCE SHEETS AS OF SEPTEMBER 30, 2020 AND 2019 (In thousands)

	2020	2019
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 55,301	\$ 6,405
Restricted cash	8,079	8,973
Short-term investments	176,752	155,962
Accounts receivable—net of allowance of \$143 and \$493, respectively	70,282	73,955
Unbilled costs, fees, and contract assets	118,685	126,247
Prepaid expenses and other current assets	<u>16,764</u>	<u>18,927</u>
Total current assets	445,863	390,469
Property and equipment, net	167,690	179,882
Investments	84,942	88,417
Goodwill, net	10,093	3,592
Other noncurrent assets	<u>26,002</u>	<u>20,033</u>
Total assets	<u>\$ 734,590</u>	<u>\$ 682,393</u>
<b>LIABILITIES AND NET ASSETS</b>		
Current Liabilities:		
Accounts payable	\$ 54,523	\$ 41,573
Line of credit	-	3,000
Current portion of long-term debt	34,100	35,200
Accrued compensated absences	30,170	29,565
Deferred revenue and contract liabilities	45,851	40,471
Other accrued expenses	<u>47,764</u>	<u>36,307</u>
Total current liabilities	212,408	186,116
Long-term Liabilities:		
Long-term debt	55,997	61,816
Other long-term liabilities	<u>31,141</u>	<u>25,158</u>
Total liabilities	<u>299,546</u>	<u>273,090</u>
Commitments and contingencies (Note 16)		
Net Assets:		
Net assets without donor restrictions	432,666	406,999
Net assets with donor restrictions	<u>2,378</u>	<u>2,304</u>
Total net assets	<u>435,044</u>	<u>409,303</u>
Total liabilities and net assets	<u>\$ 734,590</u>	<u>\$ 682,393</u>

See notes to consolidated financial statements.

# RESEARCH TRIANGLE INSTITUTE

## CONSOLIDATED STATEMENTS OF REVENUE, COSTS, AND CHANGES IN NET ASSETS FOR THE YEARS ENDED SEPTEMBER 30, 2020 AND 2019 (In thousands)

	2020	2019
Revenue	<u>\$ 912,083</u>	<u>\$ 962,871</u>
Direct costs:		
Salaries and employee benefits	293,314	295,516
Other direct costs	<u>289,403</u>	<u>345,341</u>
Total direct costs	582,717	640,857
Indirect costs	<u>321,086</u>	<u>319,461</u>
Total direct and indirect costs	<u>903,803</u>	<u>960,318</u>
Excess of revenue over direct and indirect costs	8,280	2,553
Investment income—Net	25,854	8,206
Other expense—Net	(2,191)	(393)
Interest expense—Net	<u>(6,535)</u>	<u>(12,161)</u>
Operating income (loss) before income tax expense	25,408	(1,795)
Income tax expense	<u>(232)</u>	<u>(566)</u>
Net operating income (loss)	25,176	(2,361)
Postretirement changes other than net periodic benefit costs	590	(1,611)
Currency translation	<u>(99)</u>	<u>(10)</u>
Increase (decrease) in net assets without donor restrictions	25,667	(3,982)
Increase (decrease) in net assets with donor restrictions	<u>74</u>	<u>(6)</u>
Total increase (decrease) in net assets	<u>25,741</u>	<u>(3,988)</u>
Total net assets:		
Beginning of year, as reported	409,303	414,841
Cumulative impact to net assets from adopting ASC Topic 606	<u>-</u>	<u>(1,550)</u>
Beginning of year, as adjusted	<u>409,303</u>	<u>413,291</u>
End of year	<u>\$ 435,044</u>	<u>\$ 409,303</u>

See notes to consolidated financial statements.

# RESEARCH TRIANGLE INSTITUTE

## CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED SEPTEMBER 30, 2020 AND 2019 (In thousands)

	2020	2019
Cash flows from operating activities:		
Increase (decrease) in net assets	\$ 25,741	\$ (3,988)
Adjustments to reconcile change in net assets to cash provided by operating activities:		
Depreciation and amortization	18,375	18,593
Dividends reinvested	-	(8,177)
Realized and unrealized (gain) loss on investments—net	(20,940)	3,175
Unrealized loss on derivatives—net	4,464	8,719
Distributions of earnings from unconsolidated affiliates	6,985	-
Equity in income of unconsolidated affiliates	(3,856)	(3,129)
Postretirement changes other than net periodic pension cost	(590)	1,611
Other (gain) loss—net	(71)	3,069
Changes in other operating assets and liabilities—net of effect of business acquisitions:		
Accounts receivable, unbilled costs and fees, and contract assets	12,565	(1,619)
Other operating assets	959	2,420
Accounts payable	12,394	(7,676)
Deferred revenue	4,730	(6,667)
Other operating liabilities	11,076	(4,316)
Net cash provided by operating activities	<u>71,832</u>	<u>2,015</u>
Cash flows from investing activities:		
Proceeds from sale of investments	25,987	50,350
Purchases of investments	(32,282)	(35,441)
Distributions in excess of equity in earnings of unconsolidated affiliates	2,038	-
Business acquisition	(5,025)	-
Acquisition of property and equipment	(4,767)	(14,756)
Net cash (used in) provided by investing activities	<u>(14,049)</u>	<u>153</u>
Cash flows from financing activities:		
Proceeds from lines of credit	148,172	381,669
Payments on lines of credit	(151,172)	(381,669)
Payments on variable rate term loan	(4,000)	(4,000)
Payments on bonds payable	(2,790)	(2,685)
Net cash used in financing activities	<u>(9,790)</u>	<u>(6,685)</u>
Net increase (decrease) in cash, cash equivalents, and restricted cash	47,993	(4,517)
Effect of exchange rate changes on cash and cash equivalents	9	(63)
Cash, cash equivalents, and restricted cash:		
Beginning of year	<u>15,378</u>	<u>19,958</u>
End of year	<u>\$ 63,380</u>	<u>\$ 15,378</u>
Supplemental disclosures of cash flow information—		
Cash paid during the year for:		
Income taxes	<u>\$ 261</u>	<u>\$ 419</u>
Interest	<u>\$ 3,056</u>	<u>\$ 3,532</u>

(Continued)

# RESEARCH TRIANGLE INSTITUTE

## CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED SEPTEMBER 30, 2020 AND 2019 (In thousands)

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	2020	2019
Supplemental disclosure of cash flow information—noncash transactions:		
Construction in process accruals	\$ 381	\$ 120
Acquisition contingent consideration and holdback liability	<u>\$ 2,658</u>	<u>\$ -</u>
Transfer of interest in limited partnership investment fund received	<u>\$ 2,342</u>	<u>\$ -</u>
Transfer of preferred stock investment to note receivable due to sale	<u>\$ 5,000</u>	<u>\$ -</u>
Supplemental disclosure of cash flow information— Reconciliation of cash, cash equivalents, and restricted cash reported in consolidated balance sheets:		
Cash and cash equivalents	\$55,301	\$ 6,405
Restricted cash	<u>8,079</u>	<u>8,973</u>
Total cash, cash equivalents, and restricted cash	<u>\$63,380</u>	<u>\$ 15,378</u>
See notes to consolidated financial statements.		(Concluded)



# RESEARCH TRIANGLE INSTITUTE

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED SEPTEMBER 30, 2020 AND 2019

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### 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Organization**—Research Triangle Institute (the “Institute”), which operates under the trade name RTI International, is one of the world’s leading independent nonprofit research organizations, dedicated to conducting research and development that improves the human condition by turning knowledge into practice. The Institute was established in 1958 by a joint action of Duke University, the University of North Carolina, and North Carolina State University (the latter two, which are now governed under the University of North Carolina System), as the founding tenant of Research Triangle Park, North Carolina. The Institute is a separately operated North Carolina nonprofit corporation that performs multidisciplinary research, development, and technical services under contract to clients in federal and foreign governments, industry, and public service agencies and is exempt from taxation under Section 501(c)(3) of the Internal Revenue Code (IRC). With a worldwide staff of more than 6,000 employees, the Institute offers a full spectrum of multidisciplinary services in health, education and workforce development, energy and environment, food security and agriculture, international development, and innovation.

Four individuals from the Institute’s founding institutions—Duke University and the University of North Carolina System—serve as the members of the Institute and are responsible for electing the Board of Governors. Corporate oversight is provided by the Board of Governors, which consists of representatives from the founding institutions, members elected from business and professional communities, and the president of the Institute. The Institute collaborates with its founding institutions on research programs and projects and maintains such relationships as adjunct faculty appointments, cooperative research programs, and other professional contacts. During the years ended September 30, 2020 and 2019, revenues from these activities amounted to \$5.5 million and \$7.8 million, respectively. Further, for the years ended September 30, 2020 and 2019, expenditures related to these activities amounted to \$7.0 million and \$7.2 million, respectively.

**Basis of Presentation**—The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The consolidated financial statements include the accounts of the Institute and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated.

The preparation of the consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the consolidated financial statements. Actual results could differ from those estimates.

**Subsequent Events**—Management has updated its consideration of subsequent events through December 10, 2020, the date these consolidated financial statements were issued.

**Business Combinations**—Business combinations are accounted for using the acquisition method of accounting. Under the acquisition method of accounting, acquired assets and assumed liabilities are included with the acquirer’s accounts as of the date of acquisition at estimated fair value, with any

excess of purchase price over the fair value of the net assets acquired (including certain identifiable intangible assets), capitalized as goodwill. Certain intangible assets are recognized as an asset apart from goodwill when it arises from contractual or other legal rights or if it is capable of being separated or divided from the acquired entity and sold, transferred, licensed, rented, or exchanged. Intangible assets related to noncompetition agreements or customer-related intangibles are recognized as part of goodwill. In addition, acquisition-related costs and restructuring costs are recognized as period expenses as incurred.

**Revenue Recognition**—The Institute’s sources of revenue include contract and contribution revenues primarily from agreements with agencies of the federal government.

Generally, it has been concluded that fixed fee, fee-bearing cost reimbursable, and time and materials contracts are exchange transactions subject to Accounting Standards Codification (ASC) 606, *Revenue from Contracts with Customers* (ASC 606), and grants, cooperative agreements, and non-fee-bearing cost reimbursable contracts are contributions subject to ASC 958, *Not-for-Profit Entities* (ASC 958).

**Exchange Transactions**—In accordance with ASC 606 for exchange transactions, the Institute recognizes revenue when, or as, performance obligations are satisfied under a contract. A performance obligation is the unit of account for revenue recognition and refers to a promise in a contract to transfer a distinct service or good to the customer. For the majority of contracts, the Institute combines multiple promises into a single performance obligation due to the multiple promises being either highly interrelated or through providing a significant integration of services that represent a combined output. Performance obligations may be satisfied over time or at a point in time, but the majority of the Institute’s performance obligations are satisfied over time.

The Institute evaluates whether it has an enforceable contract with a customer with rights of the parties and payment terms identified, and collectibility is probable. The Institute also evaluates if a contract has multiple promises and if each promise should be accounted for as separate performance obligations or as a single performance obligation.

The transaction price is the estimated amount of consideration expected to be received for performance under the Institute’s contracts. Contract terms may contain variable consideration. The Institute includes variable consideration in the transaction price only to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is resolved. The Institute does not include unfunded contract balances in the transaction price until funding is provided from the customer.

For the majority of its exchange transactions, the Institute recognizes revenue over time as there is a continuous transfer of control to the customer over the contract’s period of performance.

Generally, the cost-to-cost method is used to recognize revenue over time for fixed-price and cost reimbursement contracts. The cost-to-cost method recognizes revenue based on the entity’s efforts or inputs to the satisfaction of a performance obligation relative to the total expected inputs to the satisfaction of that performance obligation. The cost-to-cost method is considered a faithful representation of the delivery of services as efforts to complete a contract are expended over the period of performance. Changes in estimates of costs to complete result in the recognition of a cumulative effect adjustment in the period a change in estimate occurs. Estimated losses on agreements are provided for in the period the losses are first determined.

The Institute recognizes revenue using the right to invoice practical expedient for time and materials contracts as the Institute can invoice the customer in an amount that corresponds directly with the value received by the customer for performance completed to date.

**Contributions**—Grants, cooperative agreements, and non-fee-bearing cost reimbursable contracts are classified as contributions in instances where there is not an exchange of commensurate value. In general, the Institute recognizes revenue over the contribution agreement's period of performance and not at the time of its award. Where these agreements contain barriers and restrictions with a right of return, contribution revenue is recognized upon satisfaction of the indicated conditions, which is generally by the occurrence of an allowable cost. The Institute has elected to present contributions whose restrictions are met in the same reporting period that revenue is recognized as net assets without donor restrictions.

The Institute also enters into cost-sharing arrangements in which it receives in-kind contributed services or supplies from third-party contractors. The Institute recognized contribution revenues on contributed cost share to the Institute in the amount of \$4.1 million and \$7.1 million for the years ended September 30, 2020 and 2019, respectively. In-kind contributions received by the Institute are valued at fair value and recorded as revenue in the consolidated statement of revenue, costs, and changes in net assets. Likewise, in-kind contributions received by the Institute are recognized as an expense on the related project and are reflected as direct costs in the consolidated statement of revenue, costs, and changes in net assets.

**Expense Recognition**—Direct and indirect costs are expensed as incurred. Direct costs are those costs that can be specifically identified with a particular project. Indirect costs represent overhead costs, which primarily consist of salaries and benefits, materials and services, strategic initiatives, depreciation, rent, and utilities expenditures.

**Internal Service Center Allocations**—Indirect labor and other costs of certain service centers, such as information technology services and facilities, are charged directly to contracts and overhead cost centers as direct or indirect services.

**Concentration of Credit Risk**—Financial instruments that potentially subject the Institute to concentration of credit risk consist principally of cash and cash equivalents. The Institute places its cash and cash equivalents in the United States primarily in federally insured financial institutions, which limits its credit exposure. At times, these cash amounts may be in excess of the Federal Deposit Insurance Corporation insurance limits. In addition, as of September 30, 2020 and 2019, the Institute had approximately \$3.2 million and \$4.3 million, respectively, of international cash deposits in financial institutions that may not be insured to the same extent as monies in U.S. institutions. In order to mitigate this risk, the Institute maintains cash accounts in international financial institutions with certain required credit ratings and maintains minimal necessary balances in smaller international financial institutions.

The federal government is the Institute's major client, making up 79.3% and 81.4% of revenue for the years ended September 30, 2020 and 2019, respectively. As of September 30, 2020 and 2019, accounts receivable from the federal government amounted to \$37.3 million and \$44.1 million, respectively.

**Cash and Cash Equivalents and Restricted Cash**—All highly liquid investments purchased with an original maturity of three months or less are considered to be cash equivalents. As of September 30, 2020 and 2019, restricted cash included \$7.5 million and \$8.5 million, respectively, in customer advances that must be returned if not expended by the Institute.

**Accounts Receivable**—Accounts receivable consists of costs that have been incurred for which the Institute has invoiced the client in accordance with the contractual terms and conditions of the underlying agreements. Receivables are recorded at approved rates for services and goods. The Institute has established an allowance for uncollectible accounts based upon historical performance.

**Unbilled Costs, Fees, and Contract Assets/Deferred Revenue and Contract Liabilities**—The timing of revenue recognition may differ from the timing of billing and cash receipts from customers. Amounts are invoiced as work progresses, typically monthly in arrears, or upon achievement of contractual milestones. The Institute records an asset when revenue is recognized prior to invoicing, or a contract liability when cash is received in advance of recognizing revenue. Contract assets are recognized on exchange transactions and represent a right to consideration that is conditional upon factors other than the passage of time. Contract assets include unbillable receivables but exclude billed and billable receivables. Billed and billable receivables are rights to consideration, which are unconditional other than to the passage of time. Contract liabilities include customer advances and deferred revenue. Contract assets and liabilities are recorded net on a contract-by-contract basis and are generally classified as current based on the Institute’s contract operating cycle.

**Debt and Equity Securities**—Debt securities and equity securities with readily determinable fair values are recorded at fair value. Unrealized gains and losses associated with these securities are recognized in the consolidated statements of revenue, costs, and changes in net assets.

For equity securities without readily determinable fair values, the Institute has elected a measurement alternative whereby these securities are recorded at cost, adjusted for changes resulting from observable price changes (in orderly transactions for the identical or similar investment of the same issuer), and less impairment. To determine impairment, a qualitative assessment is performed and if this assessment indicates that impairment exists, an estimate of fair value is determined. Any impairments are recognized in the consolidated statements of revenue, costs, and changes in net assets.

**Equity Method Investments**—Equity method investments include those in which the Institute does not have control but has the ability to exercise significant influence over operating and financial policies. These investments are initially recorded at cost and are subsequently adjusted for the Institute’s share of earnings and cash contributions and distributions. The Institute analyzes other-than-temporary impairment of these investments regularly. Other-than-temporary impairments are recognized in the consolidated statements of revenue, costs, and changes in net assets.

**Property and Equipment**—Property and equipment is composed of land, research facilities, office space, furniture, computer equipment, capitalized software, and leasehold improvements, which are recorded at cost and depreciated over the asset’s useful life using the straight-line method as follows:

Buildings and improvements	10 to 45 years
Equipment and furniture	3 to 10 years
Capitalized software	3 to 5 years

Leasehold improvements are amortized over the life of the related asset or the life of the lease, whichever is shorter.

Expenditures for maintenance and repairs of property and equipment, which do not materially prolong the useful lives or significantly increase the productive capacity of the assets, are charged to indirect costs as incurred. Major expenditures for betterments or renovations are capitalized and depreciated.

The Institute also acquires equipment and furniture under its contracts with agencies of the federal government. The Institute does not have title to these assets, and these are not included in the consolidated balance sheets. The Institute must maintain an inventory and return the assets to the government entity as instructed.

**Goodwill and Intangible Assets**—Goodwill represents the excess purchase price over the fair value of the net assets acquired. The Institute has elected to amortize goodwill on a straight-line basis over 10 years and has made the election to perform goodwill impairment tests at the entity level. Goodwill is evaluated for impairment whenever events or changes in circumstances would indicate impairment. Should a triggering event occur, and the estimated fair value of the Institute is less than its respective carrying value, including goodwill, an impairment charge equal to the difference between the Institute's fair value and carrying value will be incurred.

Intangible assets consist of customer relationships, acquired customer backlog, developed technology, trademarks, and noncompete agreements. Intangible assets are stated at amortized cost and amortized based upon the asset's economic life. Intangible assets are tested for impairment whenever factors indicate the carrying amount may not be recoverable.

Goodwill is reported separately, and intangible assets are recorded in other noncurrent assets in the consolidated balance sheets.

**Derivative Instruments**—Derivatives are recognized at fair value in the consolidated balance sheets.

**Accrued Compensated Absences**—Accrued compensated absences are paid leave, which may be used by employees for time away from work for vacation, as well as for illness of the employee or family members. Full-time and part-time employees are eligible for accrued compensated absences and accrue time off at various rates depending on years of service.

**Self-Insurance**—The Institute has self-insured medical and dental plans, which cover the majority of its employees, Consolidated Omnibus Reconciliation Act participants, and all non-Medicare eligible retirees. These plans are administered by separate third-party administrators. The Institute is also self-insured for workers' compensation for employees working in the state of North Carolina. The Institute purchases, per occurrence, stop-loss insurance policies to cover medical and workers' compensation claims in excess of the policy deductibles. The appropriateness of stop-loss deductible limits is evaluated annually and adjusted as warranted.

Included in the estimated liability are estimates of incurred, but not reported claims and incremental claim adjustments. As of September 30, 2020 and 2019, the Institute had related reserves of approximately \$3.1 million and \$3.3 million, respectively, reflected in other accrued expenses in the consolidated balance sheets.

**Income Taxes**—As provided by Section 501(c)(3) of the IRC and the Internal Revenue Service's determination, the Institute's charitable, scientific, and educational operations are exempt from corporate income taxes and no provision for corporate income taxes is generally required. However, this tax exemption does not pertain to activities unrelated to the Institute's exempt purposes. The Institute's presence in certain foreign countries results in income taxation in these countries. Additionally, the Institute has several for-profit entities subject to corporate income taxation. These for-profit entities' operating losses and goodwill impairments have primarily contributed to a \$5.2 million and a \$4.2 million net deferred tax asset that has been offset with a full valuation allowance as of the years ended September 30, 2020 and 2019, respectively. Income taxes associated with foreign operations, unrelated business income, and income generated by the Institute's for-profit entities are not material for the Institute.

All not-for-profit organizations, including the Institute, are subject to the provisions of ASC 740, *Income Taxes*, related to the accounting for uncertainty in tax positions, including the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The tax benefit from an uncertain tax position is only recognized in the consolidated balance sheets if the tax position is more likely than not to be sustained upon an examination, based on the technical merits of the position. Interest and penalties, if any, are included in tax expense in the consolidated statements of revenue, costs, and changes in net assets. As of September 30, 2020 and 2019, the Institute had no uncertain tax positions that qualify for recognition or disclosure in the consolidated financial statements. The Institute's earliest open tax year for U.S. federal income tax purposes is its fiscal year ended September 30, 2017.

**Foreign Currency**—For reporting purposes, the Institute translates the assets and liabilities of its foreign entities at the exchange rates in effect at year-end. Revenue and costs are reported using average exchange rates in effect during the period. Gains and losses from foreign currency translation are credited or charged to net assets in the accompanying consolidated statements of revenue, costs, and changes in net assets. Realized exchange gains and losses are included in net operating results for the years presented.

**Net Assets**—Net assets without donor restrictions are available for the overall operations of the Institute.

Net assets with donor restrictions include contributions and other inflows of assets whose use is limited by donor-imposed stipulations that either expire by passage of time or can be fulfilled and removed by actions of the Institute pursuant to those stipulations.

Net assets with donor restrictions also include contributions and other inflows of assets whose use by the Institute is limited by donor-imposed stipulations in perpetuity. These assets primarily relate to the Institute's 25% beneficial interest in the George Watts Hill Foundation Trust (the "Trust"). The Institute is required to hold the corpus of this interest in perpetuity. Under the Trust agreement, Trust income and distributions are to be used for certain facility costs, which are defined by the Trust and are classified as restricted until these facility costs are incurred. Unrealized gains and losses on the fair value beneficial interest in the Trust are recorded as an adjustment to the beneficial interest asset and net assets with donor restrictions. As of September 30, 2020 and 2019, the fair value of the corpus of the Institute's beneficial interest asset in the Trust approximated \$1.6 million, and is recorded in other noncurrent assets in the consolidated balance sheets.

**Consolidated Statements of Revenue, Costs, and Changes in Net Assets**—The Institute utilizes a business financial reporting model similar to the accounting guidance on comprehensive income. This includes identification and use of a measure that is the functional equivalent of income from continuing operations of a for-profit organization (i.e., a performance indicator). The caption in the consolidated statements of revenue, costs, and changes in net assets titled "Net operating income (loss)" represents such a performance indicator.

## 2. RECENT ACCOUNTING PRONOUNCEMENTS

### Recently Adopted—

**Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) No. 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made***—On October 1, 2019, the Institute adopted the contributions made by a resource provider provisions of ASU No. 2018-08, which clarified how an entity determines



(1) whether transactions should be accounted for as contributions under ASC 958, or as exchange transactions subject to other guidance and (2) determining whether a contribution is conditional. The Institute adopted the contributions made by a resource provider provisions of ASU No. 2018-08 on a modified prospective basis. The adoption of this ASU did not have a material impact on the Institute's consolidated balance sheets and consolidated statements of revenue, costs, and changes in net assets.

**FASB ASU No. 2017-01, *Business Combinations (Topic 805)***—In January 2017, the FASB issued guidance that clarifies the definition of a business in order to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The Institute adopted this ASU as of October 1, 2019, on a prospective basis. The adoption of this ASU did not have an impact on the Institute's consolidated balance sheets and consolidated statements of revenue, costs, and changes in net assets.

**FASB ASU No. 2017-07, *Compensation—Retirement Benefits (Topic 715)***—In March 2017, the FASB issued guidance to improve the presentation of net periodic pension cost and net periodic postretirement benefit cost. The amendments require that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the consolidated statements of revenue, costs, and changes in net assets separately from the service cost component and outside a subtotal of income from operations, if one is presented. The Institute adopted this ASU as of October 1, 2019, on a retrospective basis. The adoption of this ASU did not have a material impact on the Institute's consolidated balance sheets and consolidated statements of revenue, costs, and changes in net assets.

**FASB ASU No. 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash***—In November 2016, the FASB issued guidance which requires that a consolidated statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning of period and end of period total amounts shown in the consolidated statements of cash flows. The Institute adopted this ASU as of October 1, 2019, on a retrospective basis which resulted in a \$1.3 million reclassification of restricted cash in total cash used in investing activities for the year ended September 30, 2019.

#### **Pending Adoption—**

**FASB ASU No. 2016-02, *Leases (Topic 842)***—In February 2016, the FASB issued new guidance related to leases. The key difference between the existing standards and ASU No. 2016-02 is the requirement for lessees to recognize in their balance sheet all lease contracts with lease terms greater than 12 months, including operating leases. Specifically, lessees are required to recognize in the balance sheet at lease commencement, both:

- A right-of-use asset, representing the lessee's right to use the leased asset over the term of the lease and
- A lease liability, representing the lessee's contractual obligation to make lease payments over the term of the lease.

For lessees, ASU No. 2016-02 requires classification of leases as either operating or finance leases, which are similar to the current operating and capital lease classifications. However, the distinction between these two classifications under the ASU does not relate to balance sheet treatment but relates to treatment and recognition in the consolidated statements of revenue, costs, and changes in net assets and cash flows. Lessor accounting is largely unchanged from current GAAP.

In June 2020, ASU No. 2020-05 delayed the effective date of the new lease standard. The guidance for all updates will be effective for the Institute as of October 1, 2020. The Institute is currently evaluating the impact of adoption on the Institute's consolidated balance sheets and consolidated statements of revenue, costs, and changes in net assets.

### **3. ACQUISITION**

On April 1, 2020, the Institute completed an acquisition of the membership interest of Market Certitude, LLC, a Delaware limited liability company doing business as Medical Data Analytics ("MDA") with its principle office located in Parsippany, New Jersey. MDA is engaged in the business of conducting retrospective, prospective, and ambispective health economics and outcome research studies for pharmaceutical, biotechnology, and other health care clients, with services including study research design, data collection and management, physician/site recruitment, and dataset production. The total consideration to acquire MDA was approximately \$7.7 million, which was comprised of \$5.9 million in cash and \$1.8 million in contingent consideration. The purchase agreement included a holdback provision, which allowed the Institute to withhold \$0.8 million of cash consideration to secure any indemnification obligations of the seller. The Institute is required to release the net holdback provision to the sellers 15 months after the closing date. As of September 30, 2020, the net holdback amount of \$0.8 million is included in accrued expenses within the accompanying consolidated balance sheets.

The purchase agreement included contingent consideration in the form of potential earn-out payments of up to \$8.3 million if MDA's revenues exceed stipulated targets during the two years following the acquisition date. As of April 1, 2020, the Institute recognized a liability of approximately \$1.8 million as the estimated fair value of the earn-out.

The Institute accounted for the transaction as an acquisition of a business, which results in a new valuation for the assets and liabilities of MDA based upon fair values as of the acquisition date. The results of MDA's operations are included in the accompanying consolidated financial statements beginning April 1, 2020. The operations of MDA are not material to the overall operations of the Institute.

Since the acquisition was completed on April 1, 2020, the final acquisition accounting remains subject to further adjustments; therefore, the measurement date remains open as of September 30, 2020, and the preliminary acquisition accounting detailed below is subject to adjustment. The Institute anticipates completing the acquisition accounting adjustments during the year ending September 30, 2021.



The Institute determined the fair value of the assets and the liabilities acquired, and recorded goodwill based on the excess of fair value of the acquisition consideration over such fair values, as follows (in thousands):

Accounts receivable	\$ 792
Unbilled costs, fees, and contract assets	486
Property and equipment	31
Goodwill	7,263
Deferred revenue and contract liabilities	(650)
Accounts payable and other accrued expenses	<u>(239)</u>
Total acquisition consideration	<u><u>\$ 7,683</u></u>

As of September 30, 2020, the Institute estimates the fair value of the earn-out to be \$1.9 million with \$1.1 million included in accrued expenses and \$0.8 million included in other long-term liabilities in the consolidated balance sheets. Any future change in the fair value of the contingent consideration subsequent to the acquisition date will be recognized in operations in the period of the change. The Institute used a discounted cash flow analysis incorporating the probability of estimated future cash flows using risk-adjusted discount rates. Changes to the discount rate would have an inverse effect on the contingent consideration fair value. The fair value is estimated based on the estimated future revenues of MDA and other unobservable inputs.

#### 4. REVENUE RECOGNITION

Revenue recognized for exchange transactions and contributions totaled \$912.1 million and \$962.9 million for the years ended September 30, 2020 and 2019, respectively, and is reported in revenue in the consolidated statements of revenue, costs, and changes in net assets. For the years ended September 30, 2020 and 2019, the Institute recognized revenues from exchange transactions of \$673.5 million and \$690.0 million, respectively, and contributions of \$238.6 million and \$272.9 million, respectively.

**Exchange Transactions**—The Institute disaggregates its revenue from contracts with customers by contract type and customer type, as management believes that they best depict how the nature, amount, timing, and uncertainty of the Institute’s revenue and cash flows are affected by economic factors. The following table summarizes revenue from contracts with customers by contract type and customer type for the years ended September 30, 2020 and 2019 (in thousands):

Contract Types	2020		
	Federal	Nonfederal	Total
Cost reimbursable	\$ 350,651	\$ 24,843	\$ 375,494
Fixed price	45,749	115,095	160,844
Time and materials	83,059	41,437	124,496
Other	<u>7,429</u>	<u>5,203</u>	<u>12,632</u>
Total revenues	<u><u>\$ 486,888</u></u>	<u><u>\$ 186,578</u></u>	<u><u>\$ 673,466</u></u>

Contract Types	2019		
	Federal	Nonfederal	Total
Cost reimbursable	\$ 385,114	\$ 9,727	\$ 394,841
Fixed price	48,970	108,636	157,606
Time and materials	87,603	34,724	122,327
Other	<u>7,671</u>	<u>7,584</u>	<u>15,255</u>
Total revenues	<u>\$ 529,358</u>	<u>\$ 160,671</u>	<u>\$ 690,029</u>

At year-end, contracts remain active and have periods of performance that extend into subsequent fiscal years. As of September 30, 2020 and 2019, the aggregate amount of contract transaction price that remains for future revenue recognition, excluding time and materials and unfunded contract balances, was \$619.1 million and \$593.4 million, respectively, the majority of which the Institute expects to recognize in revenue over the next 24 months.

The components of contract balances associated with contract assets and contract liabilities associated with exchange transactions at September 30, 2019 and 2020, consisted of the following (in thousands):

Contract Balances	Consolidated Balance Sheet Line Item	2020	2019
Contract assets	Unbilled costs, fees, and contract assets	\$ 77,211	\$ 84,234
Billable receivables	Unbilled costs, fees, and contract assets	3,095	3,492
Contract liabilities	Deferred revenue	31,513	28,290

The decrease in unbilled receivables was primarily due to the timing of billings and revenue recognized on certain contracts. The increase in deferred revenue was primarily due to the timing of advance payments from customers partially offset by revenue recognized during the year ended September 30, 2020.

The Institute expects to bill its customers for a majority of the September 30, 2020, contract assets during the next 12 months. During the years ended September 30, 2020 and 2019, the Institute recognized revenues of \$21.4 million and \$25.1 million, respectively, relating to amounts that were included as a contract liability at September 30, 2019, and October 1, 2018, respectively. It is anticipated that the majority of the deferred revenue balance at September 30, 2020, will be recognized as revenue during the next 12 months.

The Institute did not recognize any impairment losses on contract assets in the year ended September 30, 2020, and recognized a \$2.2 million impairment loss on contract assets in the year ended September 30, 2019.

**Contributions**—The table below summarizes contributions received, by type and funding source, for the years ended September 30, 2020 and 2019 (in thousands):

Agreement Types	2020		
	Federal	Nonfederal	Total
Cooperative agreement	\$ 180,309	\$ 35	\$ 180,344
Grant	38,604	10,810	49,414
Non-fee-bearing cost reimbursable	<u>5,550</u>	<u>3,309</u>	<u>8,859</u>
Total revenues	<u>\$ 224,463</u>	<u>\$ 14,154</u>	<u>\$ 238,617</u>

Agreement Types	2019		
	Federal	Nonfederal	Total
Cooperative agreement	\$ 209,744	\$ 428	\$ 210,172
Grant	43,733	15,162	58,895
Non-fee-bearing cost reimbursable	<u>808</u>	<u>2,967</u>	<u>3,775</u>
Total revenues	<u>\$ 254,285</u>	<u>\$ 18,557</u>	<u>\$ 272,842</u>

As of September 30, 2020 and 2019, the aggregate amount of conditional promises to be received in future years related to the Institute's ongoing operating programs totaled \$534.7 million and \$237.4 million, respectively. The Institute had billable receivables of \$38.4 million and \$38.5 million for contributions at September 30, 2020 and 2019, respectively, and is included in the unbilled costs, fees, and contract assets line in the consolidated balance sheets.

## 5. FUNCTIONAL EXPENSES

The Institute performs applied and basic research and technical services under contract to clients in business, industry, public service agencies, and federal and foreign governments. Costs are allocated in accordance with Cost Accounting Standards established by the federal government. Expenses, by function, related to providing these services during the years ended September 30, 2020 and 2019, are as follows (in thousands):

	2020	2019
Programs expense (including research and other projects):		
Salaries and employee benefits	\$ 417,133	\$ 490,978
Subcontractor and consultant costs	182,144	188,961
Other direct program costs	<u>186,842</u>	<u>234,956</u>
Total programs expense	<u>786,119</u>	<u>914,895</u>
Support expense (principally general and administrative):		
Salaries and employee benefits	94,583	21,605
Other support costs	<u>23,101</u>	<u>23,818</u>
Total support expense	<u>117,684</u>	<u>45,423</u>
Total	<u>\$ 903,803</u>	<u>\$ 960,318</u>

## 6. LIQUIDITY

The Institute's financial assets available for general expenditure within one year of September 30, 2020 and 2019, include the following (in thousands):

	2020	2019
Cash and cash equivalents	\$ 55,301	\$ 6,405
Short-term investments	176,752	155,962
Accounts receivable—net	70,282	73,955
Unbilled costs, fees, and contract assets	<u>118,685</u>	<u>126,247</u>
	<u>\$421,020</u>	<u>\$362,569</u>

None of the financial assets are subject to donor or other contractual restrictions that make them unavailable for general expenditure within one year of the consolidated balance sheet date. The accounts receivable balance is subject to implied time restrictions, but are expected to be collected within one year. The Institute has a goal to maintain financial assets, which consist of cash, cash equivalents, and investments, on hand to meet 15% of the Institute's annual revenue, which is approximately \$136.8 million as of September 30, 2020. The Institute has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. In addition, as part of its liquidity management, the Institute invests cash in excess of daily requirements in various short-term investments. As more fully described in Note 10, the Institute also has an operating line of credit, which matures in April 2021, which it can draw up to \$75.0 million and \$50.0 million, as of September 30, 2020 and 2019, respectively, in the event of an unanticipated liquidity need.

## 7. INVESTMENTS

Short-term investments and noncurrent investments consisted of the following as of September 30, 2020 and 2019 (in thousands):

	2020	2019
Short-term investments—debt and equity securities	<u>\$ 176,752</u>	<u>\$ 155,962</u>
Noncurrent investments:		
GEM investment fund	67,200	64,457
Debt securities	3,460	5,897
Equity method investments	-	7,100
Other noncurrent investments	<u>14,282</u>	<u>10,963</u>
Total noncurrent investments	<u>84,942</u>	<u>88,417</u>
Total investments	<u>\$ 261,694</u>	<u>\$ 244,379</u>

Realized and unrealized gains and losses on investments are recorded in investment income, net in the consolidated statements of revenue, costs, and changes in net assets.

**Debt and Equity Securities**—Short-term debt and equity securities are primarily composed of U.S. Treasury securities, U.S. government and agency bonds and mortgage-backed securities, corporate equity and debt obligations, and multiasset mutual funds. These securities are recorded at fair value. Additionally, as discussed further below, as of September 30, 2020, this balance also included ownership in a limited partnership liquidated shortly after year-end.

**GEM Investment Fund**—The Institute has an investment in a global multiasset fund, Global Endowment Fund II (GEM), with a cost basis of \$50.0 million and estimated net asset value of \$67.2 million and \$64.5 million at September 30, 2020 and 2019, respectively. Withdrawals from the fund have restrictions, and certain distributions require approval of the general partner and as such, this investment has been classified as noncurrent investments within the consolidated balance sheets.

**Debt Securities**—As of September 30, 2020 and 2019, the Institute held convertible notes with several privately held companies of \$3.5 million and \$5.9 million, respectively. These securities are recorded at fair value and generally mature within two years of issuance. Each note has similar conversion features, such as upon qualified or nonqualified financing, corporate transaction, or maturity. During the year ended September 30, 2020, there were no recorded unrealized gains on these securities compared to \$0.5 million for the year ended September 30, 2019.

**Equity Method Investments**—The Institute has investments in a limited partnership and preferred and common stock of several privately held companies, which are accounted for under the equity method. For the years ended September 30, 2020 and 2019, the Institute recorded \$3.9 million and \$3.1 million, respectively, in equity method income related to a limited partnership investment fund. In August 2020, the Institute received a distribution from the limited partnership investment fund for \$11.3 million with \$9.0 million in cash proceeds and \$2.3 million as a noncash transfer of interest in a newly established limited partnership investment fund, which is included in debt and equity securities as of September 30, 2020. In November 2020, the Institute liquidated the newly established limited partnership investment fund for \$2.3 million in cash proceeds.

No equity method income or losses were recorded for the Institute's other equity investments for the years ended September 30, 2020 or 2019.

**Other Noncurrent Investments**—As of September 30, 2020 and 2019, the Institute had \$9.1 million and \$5.9 million, respectively, invested in noncontrolling interests in equity investments in several privately held companies through preferred stock. These equity securities are recorded at initial cost, adjusted for observable transactions, less impairment, given they are equity securities with no readily determinable fair value. Since acquisition, no observable transactions, impairments, downward adjustments, or upward adjustments have been recorded on these investments.

As of September 30, 2020, the Institute had \$5.2 million invested in four private equity partnerships through the Commonfund compared to \$5.0 million at September 30, 2019. The Institute has committed future funds totaling \$1.6 million to these four different partnerships as of September 30, 2020. When fully funded, the Institute will have 3% or less ownership in each partnership. As these partnerships do not have a readily determinable fair value, the Institute's interest is measured at cost, adjusting for observable transactions, less impairment. Since acquisition, no observable transactions, impairments, downward adjustments, or upward adjustments have been recorded on these investments. The Institute recognized realized gains of \$0.5 million through the Commonfund partnerships for both years ended September 30, 2020 and 2019.

## 8. PROPERTY AND EQUIPMENT

Property and equipment as of September 30, 2020 and 2019, consisted of the following (in thousands):

	2020	2019
Land	\$ 2,674	\$ 2,674
Buildings and improvements	255,192	264,993
Equipment and furniture	94,182	91,570
Construction in process	<u>2,913</u>	<u>5,426</u>
Total property and equipment at cost	354,961	364,663
Less accumulated depreciation	<u>187,271</u>	<u>184,781</u>
Property and equipment	<u>\$ 167,690</u>	<u>\$ 179,882</u>

Depreciation expense for the years ended September 30, 2020 and 2019, was \$17.1 million and \$17.5 million, respectively.

During the year ended September 30, 2019, the Institute transferred highly specialized lab equipment to assets held for sale from property and equipment, with an original net book value of \$1.3 million. The Institute incurred a \$0.5 million impairment charge upon transfer for the year ended September 30, 2019. During the year ended September 30, 2020, the Institute recognized an additional impairment charge of \$0.3 million related to these assets held for sale. The asset has a fair value of \$0.5 million and \$0.8 million as of September 30, 2020 and 2019, respectively.

## 9. GOODWILL AND OTHER INTANGIBLE ASSETS

The following table details the changes in goodwill for the years ended September 30, 2020 and 2019 (in thousands):

	Goodwill	Accumulated Impairment	Accumulated Amortization	Goodwill—Net
September 30, 2018	\$ 17,263	\$ (13,272)	\$ -	\$ 3,991
Amortization	<u>-</u>	<u>-</u>	<u>(399)</u>	<u>(399)</u>
September 30, 2019	17,263	(13,272)	(399)	3,592
MDA acquisition	7,263	-	-	7,263
Amortization	<u>-</u>	<u>-</u>	<u>(762)</u>	<u>(762)</u>
September 30, 2020	<u>\$ 24,526</u>	<u>\$ (13,272)</u>	<u>\$ (1,161)</u>	<u>\$ 10,093</u>

Amortization is applied on a straight-line basis over a period of 10 years and is recorded in other expense in the consolidated statements of revenue, costs, and changes in net assets.

Other intangible assets are included within other noncurrent assets in the accompanying consolidated balance sheets and consist of the following for the years ended September 30, 2020 and 2019 (in thousands):

	<b>2020</b>		
	<b>Gross Carrying Value</b>	<b>Accumulated Amortization</b>	<b>Net Carrying Value</b>
Customer relationships	\$ 4,600	\$ 1,817	\$ 2,783
Exclusive license	2,300	332	1,968
Other	<u>2,126</u>	<u>1,315</u>	<u>811</u>
Total other intangible assets	<u>\$ 9,026</u>	<u>\$ 3,464</u>	<u>\$ 5,562</u>

  

	<b>2019</b>		
	<b>Gross Carrying Value</b>	<b>Accumulated Amortization</b>	<b>Net Carrying Value</b>
Customer relationships	\$ 4,600	\$ 1,434	\$ 3,166
Exclusive license	2,300	256	2,044
Other	<u>2,126</u>	<u>1,108</u>	<u>1,018</u>
Total other intangible assets	<u>\$ 9,026</u>	<u>\$ 2,798</u>	<u>\$ 6,228</u>

Amortization expense for other intangible assets was \$0.7 million and \$0.8 million for the years ended September 30, 2020 and 2019, respectively. Each intangible asset is amortized on a straight-line basis and is recorded in other expense in the consolidated statements of revenue, costs, and changes in net assets.

In the aggregate, these assets had a weighted-average expected useful life of 18 years from the date of acquisition. Estimated future amortization expense associated with other intangible assets at September 30, 2020, is as follows (in thousands):

**Years Ending  
September 30**

2021	\$ 605
2022	545
2023	526
2024	526
2025	526
Thereafter	<u>2,834</u>
	<u>\$ 5,562</u>

## 10. DEBT

A summary of Institute's debt as of September 30, 2020 and 2019, is as follows (in thousands):

	2020	2019
Variable-rate revolving line of credit	\$ -	\$ 3,000
Variable-rate term loan	52,000	56,000
Variable-rate Series 2007 Revenue Bonds	28,410	29,585
Fixed-rate Series 2010 Revenue Bonds	9,345	10,960
Plus unamortized premium	<u>342</u>	<u>471</u>
Total outstanding debt	<u>90,097</u>	<u>100,016</u>
Current maturities of long-term debt	6,910	9,790
Current classification due to redemption features	<u>27,190</u>	<u>28,410</u>
Total current maturities of long-term debt	<u>34,100</u>	<u>38,200</u>
Total long-term debt	<u>\$ 55,997</u>	<u>\$ 61,816</u>

The combined aggregate amount of maturity and annual mandatory sinking fund requirements for the years subsequent to the year ended September 30, 2020, are as follows (in thousands):

### Years Ending September 30

2021	\$ 6,910
2022	7,040
2023	7,160
2024	7,365
2025	7,450
2026 and thereafter	<u>53,830</u>
Total	<u>\$ 89,755</u>

The carrying amount of the Institute's debt as of the consolidated balance sheet date approximates fair value. The fair value of these instruments is determined using Level 2 inputs within the fair value hierarchy and based on quoted market prices for similar instruments or on current rates offered for debt with similar maturities.

**Lines of Credit**—The Institute had an unsecured \$50.0 million revolving line of credit as of September 30, 2019. On April 30, 2020, the Institute amended its unsecured revolving line of credit and increased the aggregate maximum borrowings of up to \$75.0 million. No balances were outstanding under the revolving line of credit as of September 30, 2020 and 2019. For 2020 and 2019, there were issued outstanding letters of credit in the amount of \$2.6 million and \$1.6 million, respectively, reducing the available balance on the revolving line of credit to \$72.4 million and \$48.4 million as of September 30, 2020 and 2019, respectively. Interest is accrued at an interest rate indexed to LIBOR, plus 1.45%. All borrowings under the unsecured revolving line of credit mature on April 29, 2021.



RTI Syntegrity, a consolidated subsidiary of the Institute, had an unsecured \$3.0 million revolving line of credit with the entire line of \$3.0 million outstanding as of September 30, 2019. Interest accrued at a rate equal to LIBOR, plus 1.25% per annum. In August 2020, the Institute paid the outstanding amount and subsequently terminated the RTI Syntegrity line of credit.

**Variable Term Loan**—On January 1, 2018, the Institute entered into a \$60.0 million term loan to finance the construction of an office building and parking deck located on the Institute's campus in Research Triangle Park (RTP). The term loan will mature on January 1, 2033. The term loan required annual principal payments of \$4.0 million with interest payments due monthly. Borrowings under the term loan bear an interest rate indexed to LIBOR, plus 0.8%.

To mitigate changes in interest rates, upon entering the loan agreement, the Institute simultaneously entered an interest rate swap to achieve an effective fixed interest rate of 2.49%. Refer to Note 11 for additional information.

**Series 2007 Revenue Bonds**—In November 2007, the Durham County Industrial Facilities and Pollution Control Financing Authority ("Durham County") issued the Series 2007 Revenue Bonds on behalf of the Institute. The payment of the principal and interest on the bonds is additionally secured currently by an irrevocable, direct-pay letter of credit issued by Wells Fargo Bank. The Series 2007 Revenue Bonds were issued to provide funds to finance (a) the cost of constructing and equipping an office building and parking deck to be located on the RTP campus; (b) the cost of refinancing certain indebtedness previously incurred by the Institute to finance improvements on the Institute's campus; and (c) certain expenses incurred in connection with the authorization and issuance of the bonds, including certain initial costs associated with the issuance of the letter of credit.

The Series 2007 Revenue Bonds are subject to optional, extraordinary, and mandatory redemption, including redemption at par, and optional and mandatory tender for purchase prior to the stated maturity of September 2037. The bonds bear interest at a weekly rate, determined by prevailing market conditions and payable monthly in arrears. The Series 2007 Revenue Bonds are subject to mandatory sinking fund redemption payments on September 1 annually through 2037.

The irrevocable, direct-pay letter of credit was issued to ensure bond payments to the bondholders and to enhance the credit rating of the bonds. In the event that the Series 2007 Revenue Bonds are not successfully remarketed, the Institute would be obligated to reimburse Wells Fargo Bank for any bonds tendered and not remarketed. The direct-pay letter of credit expires in August 2021. Given the Series 2007 Revenue Bonds' redemption features and the irrevocable, direct-pay letter of credit's material adverse event clause, this debt is presented as a current liability.

Additionally, the Institute executed a 30-year floating- to fixed-interest-rate swap to provide interest rate protection for the Series 2007 Revenue Bonds and effectively created synthetic fixed-rate debt at a borrowing rate of 3.75%. Refer to Note 11 for additional information.

**Series 2010 Revenue Bonds**—In February 2010, Durham County issued \$23.0 million, 15-year tax-exempt fixed-rate Series 2010 Revenue Bonds on behalf of the Institute. The Series 2010 Revenue Bonds were issued pursuant to indentures between Durham County and trustee and are payable pursuant to a loan agreement, between Durham County and the Institute. The Series 2010 Revenue Bonds were issued to provide funds to (a) finance the construction and equipping of a new office building and related parking deck on the RTP campus and (b) pay and reimburse the Institute for paying certain expenses incurred in connection with the issuance of the Series 2010 Revenue Bonds.

The Series 2010 Revenue Bonds were issued at a premium of \$1.9 million. The average coupon rate of the bonds approximated 4.37% and the effective interest rate approximated 3.14%.

The Series 2010 Revenue Bonds are not subject to optional redemption before maturity but are subject to extraordinary mandatory redemption prior to the stated maturity of February 1, 2025.

**Debt Covenants**—Certain of the Institute’s loan agreements and direct-pay letters of credit contain various covenants, including cross-default provisions and certain financial covenants. As of September 30, 2020, the Institute believes it was in compliance with all covenants that were in effect on such date.

## 11. DERIVATIVE INSTRUMENTS

The following table summarizes the fair value of the Institute’s derivatives by type at September 30, 2020 and 2019 (in thousands):

Financial Instrument	Balance Sheet Account	Fair Value	
		2020	2019
Interest rate swap	Other long-term liabilities	<u>\$ (12,924)</u>	<u>\$ (8,502)</u>

**Interest Rate Swaps**—During the year ended September 30, 2017, the Institute entered a floating- to fixed-interest-rate swap to manage fluctuations in cash flows resulting from the variable term loan entered during fiscal year 2017. The swap has a notional amount of \$60.0 million with an effective date of January 1, 2018, and a termination date of January 1, 2033. As of September 30, 2020, the swap had a remaining notional amount of \$52.0 million. Under the interest rate swap, the Institute receives LIBOR-based variable interest payments and makes fixed interest rate payments at 2.49%. The Institute did not designate the interest rate swap as a hedge in accordance with the accounting standards on derivatives and hedging.

The Institute also entered a floating- to fixed-interest-rate swap to manage fluctuations in cash flows resulting from the issuance of the Series 2007 Revenue Bonds. The swap had an original notional amount of \$40.6 million and termination date of September 1, 2037. As of September 30, 2020, the swap had a remaining notional amount of \$28.4 million. Under the interest rate swap, the Institute receives LIBOR-based variable interest payments and makes fixed-interest-rate payments at 3.75%. The Institute did not designate the interest rate swap as a hedge in accordance with the accounting standards on derivatives and hedging.

**Foreign Currency Forward Contracts**—From time to time, the Institute enters into currency rate protection agreements (“FX forward contracts”) to manage the foreign currency exchange exposure risk on transactions denominated in foreign currencies. The Institute had a nominal amount of FX forward contracts outstanding as of September 30, 2020 and 2019. These FX forward contracts typically have maturity dates ranging from less than a year to two years. The Institute did not designate these contracts for hedge accounting in accordance with the accounting standards on derivatives and hedging.

The following table summarizes the earning effects of derivatives in the consolidated statements of revenue, costs, and changes in net assets for the years ended September 30, 2020 and 2019 (in thousands):

Financial Instrument	Location of (Loss) Gain	(Loss) Gain Recognized	
		2020	2019
Interest rate swap	Interest expense—net	\$ (4,422)	\$ (8,742)
FX currency forward contracts	Other expense—net	<u>(42)</u>	<u>23</u>
Total		<u>\$ (4,464)</u>	<u>\$ (8,719)</u>

Financial instruments, including derivatives, expose the Institute to credit loss in the event of nonperformance by counterparties. The Institute manages its exposure to counterparty credit risk through procedures to monitor the counterparty's financial standing. If a counterparty fails to meet the terms of an arrangement, the Institute's exposure is limited to the net amount that would have been received, if any, over the arrangement's remaining life. Currently, the Institute does not anticipate nonperformance by any counterparty and no material loss is expected from such nonperformance.

## 12. FAIR VALUE MEASUREMENTS

Fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between independent market participants at the measurement date. To increase consistency and comparability in fair value measurements, a fair value hierarchy was established that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

**Level 1**—Quoted prices for identical instruments in active markets.

**Level 2**—Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable, such as interest rates, credit risks, and net asset value.

**Level 3**—Significant unobservable inputs (including the Institute's own assumptions in determining the fair value of assets and liabilities).

The following sections provide a description of the valuation methodologies used for instruments measured at fair value as well as the general classification of such instruments pursuant to the fair value hierarchy:

**Investment Securities**—Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities would include highly liquid government bonds, such as Treasury securities and exchange-traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, discounted cash flow, or at net asset value per share. Level 2 securities would include U.S. government agency securities; obligations of states and political subdivisions; and certain corporate, asset-backed, multiasset fund, and other securities. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy.

**Nonqualified Deferred Compensation Plan—Mutual Funds**—These are valued at the daily closing price as reported by the fund. Mutual funds held by the plan are open-end mutual funds that are registered with the Securities and Exchange Commission. These funds are required to publish their daily net asset value and to transact at that price. The mutual funds held by the plan are deemed to be actively traded; thus, the investment is classified within Level 1 of the valuation hierarchy.

**Derivatives**—Derivative instruments include interest rate swaps and are valued on a recurring basis using quoted market prices, dealer quotes, or third-party pricing models that are primarily sensitive to market observable data. Current outstanding derivatives are classified as Level 2 within the fair value hierarchy.

Financial assets and liabilities recorded at fair value on a recurring basis as of September 30, 2020 and 2019, were as follows (in thousands):

Description	2020			
	Total	Level 1	Level 2	Level 3
<b>ASSETS</b>				
Short-term investments:				
US Treasury securities	\$ 35,643	\$ 35,643	\$ -	\$ -
Federal agency securities	1,675	-	1,675	-
Corporate debt obligations	5,212	-	5,212	-
Multiasset fund	131,851	-	131,851	-
Short-term limited partnership securities	2,342	2,342	-	-
Ultra short-term bond securities	29	29	-	-
Total short-term investments	176,752	38,014	138,738	-
Securities with donor restrictions	1,631	-	1,631	-
Noncurrent assets:				
Nonqualified deferred compensation plan—mutual funds	8,529	8,529	-	-
Debt securities	3,460	-	-	3,460
GEM investment fund—measured at net asset value	67,200	-	-	-
Total noncurrent assets	79,189	8,529	-	3,460
Total assets	<u>\$ 257,572</u>	<u>\$ 46,543</u>	<u>\$ 140,369</u>	<u>\$ 3,460</u>
<b>LIABILITIES</b>				
Contingent obligations related to acquisition	\$ 1,121	\$ -	\$ -	\$ 1,121
Other long-term liabilities:				
Derivatives—interest rate swaps	12,924	-	12,924	-
Contingent obligations related to acquisition	737	-	-	737
Nonqualified deferred compensation plan obligation	8,529	8,529	-	-
Total other long-term liabilities	22,190	8,529	12,924	737
Total liabilities	<u>\$ 23,311</u>	<u>\$ 8,529</u>	<u>\$ 12,924</u>	<u>\$ 1,858</u>

Description	2019			
	Total	Level 1	Level 2	Level 3
<b>ASSETS</b>				
Short-term investments:				
US Treasury securities	\$ 32,210	\$ 32,210	\$ -	\$ -
Federal agency securities	4,733	-	4,733	-
Corporate debt obligations	3,555	-	3,555	-
Multiasset fund	115,435	-	115,435	-
Ultra short-term bond securities	29	29	-	-
Total short-term investments	<u>155,962</u>	<u>32,239</u>	<u>123,723</u>	<u>-</u>
Securities with donor restrictions	<u>1,630</u>	<u>-</u>	<u>1,630</u>	<u>-</u>
Noncurrent assets:				
Nonqualified deferred compensation plan—mutual funds	7,937	7,937	-	-
Debt securities	5,897	-	-	5,897
GEM investment fund—measured at net asset value	64,457	-	-	-
Total noncurrent assets	<u>78,291</u>	<u>7,937</u>	<u>-</u>	<u>5,897</u>
Total assets	<u>\$ 235,883</u>	<u>\$ 40,176</u>	<u>\$ 125,353</u>	<u>\$ 5,897</u>
<b>LIABILITIES</b>				
Other long-term liabilities:				
Derivatives—interest rate swaps	\$ 8,502	\$ -	\$ 8,502	\$ -
Nonqualified deferred compensation plan obligation	<u>7,937</u>	<u>7,937</u>	<u>-</u>	<u>-</u>
Total liabilities	<u>\$ 16,439</u>	<u>\$ 7,937</u>	<u>\$ 8,502</u>	<u>\$ -</u>

The carrying value of the Institute's other financial instruments, including cash and cash equivalents, accounts receivable, unbilled costs, fees and contract assets, prepaid expenses and other current assets, accounts payable, deferred revenue and contract liabilities, and other accrued expenses, approximates fair value as of September 30, 2020 and 2019.

There were no changes during the periods presented to the valuation techniques the Institute used to measure asset and liability fair values on a recurring basis.

Certain of the Institute's nonfinancial assets and liabilities are subject to impairment analysis, including long-lived assets, intangible assets, and goodwill. The significant inputs utilized in these analyses are classified as Level 3 in the fair value hierarchy. The Institute did not have any other nonfinancial assets or liabilities that were required to be measured at fair value on a nonrecurring basis for the year ended September 30, 2020 or 2019.

### 13. EMPLOYEE RETIREMENT PLANS

The Institute has a defined contribution plan covering all US-based employees who are 19 years of age or older with one year of 500 hours or more of continuous service during the plan year. Each U.S. employee of the Institute is immediately eligible to make elective deferrals under the plan. Employees are eligible to receive Institute contributions once they have completed one year of continuous service.

The Institute's contributions to the plan for the year ended September 30, 2020, were \$24.2 million, with \$0.7 million in applied forfeitures. The Institute's contributions to the plan for the year ended September 30, 2019, were \$23.8 million, with \$0.7 million in applied forfeitures.

#### 14. DEFERRED COMPENSATION PLANS

The Institute maintains an Employee Retirement Income Security Act of 1974 nonqualified deferred compensation plan under IRC Section 457 to permit eligible employees to save for their retirement.

A Salary Deferral Arrangement 457(b) plan is available to certain highly compensated employees. Participation is voluntary and permits eligible employees to defer compensation up to a maximum annual amount established by federal law. There are no Institute contributions associated with this deferred compensation plan. Invested employee deferrals are recorded at fair value, which totaled \$8.5 million and \$7.9 million at September 30, 2020 and 2019, respectively, and are included in other noncurrent assets with an offsetting deferred compensation obligation recorded in other long-term liabilities. Deferred amounts ultimately payable to the participants are based on the value of the underlying investments.

#### 15. POSTRETIREMENT BENEFITS OTHER THAN PENSIONS

The Institute provides medical and dental benefits to certain retired employees under the Research Triangle Institute Retiree Medical and Dental Plan (the "Plan"). Employees become eligible for benefits after meeting certain age and service requirements. During fiscal year 2020, the Plan was amended to limit eligibility to employees hired prior to January 1, 2021, and to freeze the creditable service towards earning medical premium credits for eligible employees as of December 31, 2020. The amendment resulted in a reduction in the benefit obligation of \$0.8 million and immediate recognition of the unrecognized prior service cost of \$0.4 million, leading to a net curtailment gain of \$0.4 million recognized in indirect costs in the consolidated statements of revenue, costs, and changes in net assets.

**Cost of Postretirement Benefits**—The cost of providing retiree medical and dental benefits is actuarially determined and accrued over the active service period of eligible employees. The components of the net periodic postretirement benefit cost for the years ended September 30, 2020 and 2019, are presented in the following table (in thousands):

	2020	2019
Service cost	\$ 621	\$ 530
Interest cost	388	470
Expected return on Plan assets	(760)	(772)
Amortization of prior service cost	202	177
Amortization of net gain	-	(73)
Curtailment gain	<u>(397)</u>	<u>-</u>
Net periodic postretirement benefit cost	<u>\$ 54</u>	<u>\$ 332</u>

The net periodic postretirement benefit cost is reflected in the consolidated statements of revenue, costs, and changes in net assets as indirect costs.

**Benefit Obligations and Accrued Costs**—The funded status of the postretirement benefit plan is measured as the difference between the fair value of the Plan assets and the benefit obligation.

The following table sets forth the changes in the Institute's benefit obligations and the benefit plan's funded status for the years ended September 30, 2020 and 2019 (in thousands):

	2020	2019
Change in benefit obligation:		
Postretirement benefit obligation at beginning of year	\$ 13,490	\$ 11,777
Service cost	621	530
Interest cost	388	470
Plan amendments	-	259
Actuarial loss	416	1,150
Plan participant contributions	1,270	1,104
Benefits paid	(1,142)	(1,800)
Gain due to curtailment	(813)	-
	<u>14,230</u>	<u>13,490</u>
Postretirement benefit obligation at end of year	14,230	13,490
Fair value of Plan assets at end of year	<u>14,870</u>	<u>13,594</u>
Funded status	<u>\$ 640</u>	<u>\$ 104</u>

The funded status as of September 30, 2020 and 2019, was in an overfunded position. The funded status of the Plan is reflected in the consolidated balance sheets as other noncurrent assets. The funded status is dependent upon many factors, including returns on invested assets and the level of market interest rates.

A summary of amounts included in net assets without donor restrictions as of September 30, 2020 and 2019, that have not been recognized as components of net periodic benefit cost is as follows (in thousands):

	2020	2019
Net actuarial gain	\$ (1,027)	\$ (1,055)
Prior service cost	<u>-</u>	<u>618</u>
Total	<u>\$ (1,027)</u>	<u>\$ (437)</u>

Due to the Plan amendment resulting in immediate recognition of the unrecognized prior service cost in fiscal year 2020, the Institute does not expect to recognize any portion of the above amounts as components of net periodic postretirement benefit cost in the year ending September 30, 2021.

Amounts recognized as a change in Institute's net assets, but reflected outside of the performance indicator for the years ended September 30, 2020 and 2019, were as follows (in thousands):

	2020	2019
Net actuarial (gain) loss	\$ (785)	\$ 1,456
Reclassification of amortization of transition obligation, prior service costs, and actuarial gain	<u>195</u>	<u>155</u>
Total	<u>\$ (590)</u>	<u>\$ 1,611</u>

The following weighted-average assumptions were used in calculating the above benefit obligations, net periodic benefit cost, and fair value of Plan assets at September 30, 2020 and 2019:

	2020	2019
Discount rate used to determine benefit obligation	2.4 %	3.0 %
Expected return on Plan assets	5.8	5.8

The change in the discount rate is attributed to fluctuations in the interest rate environment resulting from the Federal Reserve monetary policy and global economic pressures during the current year. The Plan seeks to achieve a total return on Plan assets (price appreciation, plus dividends) that, over a majority of market cycles, exceeds the estimated discount rate used to determine the benefit obligation, which the benefit obligation discount rate is assumed to be 2.4% per annum. The total expected long-term rate of return on the Plan portfolio is based upon the portfolio's historical allocated fund performance since the funds' inception.

Health care cost trends do not have a significant effect on the obligation or net periodic benefit costs.

**Postretirement Plan Assets**—The following table sets forth the changes in the fair value of Plan assets for the years ended September 30, 2020 and 2019 (in thousands):

	2020	2019
Fair value of Plan assets at beginning of year	\$ 13,594	\$ 13,825
Return on Plan assets, less trustee's fee	1,148	465
Employer contributions	-	-
Plan participant contributions	1,270	1,104
Benefits paid	<u>(1,142)</u>	<u>(1,800)</u>
Fair value of Plan assets at end of year	<u>\$ 14,870</u>	<u>\$ 13,594</u>



The investment objectives of the Institute's Plan are designed to generate returns that will enable the Plan to meet its future obligations. The Plan's targeted strategic allocation to each asset class was determined in collaboration with Wells Fargo Institutional Retirement and Trust using its asset risk tolerance modeling. The Institute currently targets a "Balanced Income" strategic asset allocation that provides for an allocation range around target of plus or minus 5% for each asset category. The Plan will, at times, also invest in money market funds as it seeks to rebalance the strategic asset allocation, reinvest portfolio capital gains and/or dividends, or reinvest maturing bond proceeds. The fair values of Plan assets and related strategic asset allocations at September 30, 2020 and 2019, are as follows (in thousands):

<b>Asset Category</b>	<b>Fair Value <sup>(a)</sup></b>		<b>Asset Allocation Target</b>
	<b>2020</b>	<b>2019</b>	
Cash and cash equivalents	\$ 408	\$ 51	- %
Bond mutual funds (investment grade)	<u>6,009</u>	<u>5,941</u>	<u>50</u>
Equity mutual funds:			
Large/mid cap	5,891	5,374	30
Small cap	842	768	10
International	<u>1,720</u>	<u>1,460</u>	<u>10</u>
Total equity mutual funds	<u>8,453</u>	<u>7,602</u>	<u>50</u>
Noninvestment assets	<u>14,870</u>	<u>13,594</u>	<u>100 %</u>
Total Plan assets	<u>\$ 14,870</u>	<u>\$ 13,594</u>	

<sup>(a)</sup> All investments, excluding cash and cash equivalents, held by the Plan are considered Level 1 assets within the fair value hierarchy.

The Institute contributes to the Plan based on actuarially determined amounts necessary to provide assets sufficient to meet benefits to be paid to Plan members. The Institute's policy is to fund the above-mentioned benefits quarterly. Attributed to the overfunded status of the Plan, the Institute did not make contributions to postretirement plan assets in fiscal year 2020 and does not anticipate making contributions to postretirement plan assets in fiscal year 2021.

The following schedule summarizes net benefit payments that are expected to be made in the years ending September 30, which reflect expected future service (in thousands):

**Years Ending  
September 30**

2021	\$ 759
2022	906
2023	879
2024	844
2025	821
Five subsequent years ending 2030	<u>3,919</u>
Total	<u>\$ 8,128</u>

## 16. COMMITMENTS AND CONTINGENCIES

**Leases**—The Institute leases certain office and research facilities and equipment under operating leases, which expire in various years through fiscal year 2028. Certain of these leases contain escalation clauses, which increase the annual rentals for increases in building operating costs as well as clauses for renewal.

Commitments for future minimum lease payments under operating leases, which have initial or remaining noncancelable lease terms in excess of one year at September 30, 2020, are as follows (in thousands):

**Years Ending  
September 30**

2021	\$ 8,992
2022	7,816
2023	6,420
2024	5,783
2025	5,496
2026 and thereafter	<u>6,611</u>
Total minimum lease payments	<u>\$ 41,118</u>

Rent expense for the years ended September 30, 2020 and 2019, was \$14.2 million and \$14.4 million, respectively. Rent expense for domestic locations consists of operating leases for office and research facilities and totaled \$8.1 million and \$8.5 million for the years ended September 30, 2020 and 2019, respectively. International leases include operating leases for facilities and equipment and are usually shorter term in nature. These are charged to related projects and totaled \$6.1 million and \$5.9 million for the years ended September 30, 2020 and 2019, respectively.

**Risk and Uncertainties**—In March 2020, the World Health Organization classified the COVID-19 outbreak as a pandemic, based on the rapid increase in exposure globally. In response to the global pandemic, the Institute instructed all employees to adhere to country and local government restrictions, including but not limited to, shelter-in-place orders, quarantines, travel restrictions, social

distancing practices, as well as restrictions that prohibit many employees from going to work. While certain country and local governments have eased some restrictions, the pandemic continues to be disruptive to the Institute's operations and workforce.

The full impact of the COVID-19 outbreak continues to evolve as of the date of this report. As such, the Institute cannot reasonably estimate the continued duration or severity of the pandemic and related impact to the Institute's future financial condition, liquidity, results of operations, industry, and workforce.

**Related-Party Guarantee**—In September 2020, the Institute entered into an unconditional guaranty of an investee of its ratable share of a revolving line of credit. The Institute's ratable share of the revolving line of credit is up to \$2.9 million. Failure of the investee to pay any amount under the line of credit facility or otherwise default on this obligation would allow the lender to call the guarantee agreement and require the Institute to pay up to \$2.9 million, plus accrued and unpaid interest and bank expenses. No amounts have been recorded as of September 30, 2020, for this guarantee as the Institute considers the possibility of paying this obligation on behalf of the investee to be remote.

**Legal and Regulatory Matters**—The Institute is involved in litigation, administrative proceedings, and regulatory examinations arising in the normal course of business. Management believes that the ultimate outcome of these matters will not have a material impact on the Institute's net assets, operations, or cash flows.

**Other Contingencies**—The Institute has negotiated and settled final indirect costs through fiscal year 2018 with its cognizant federal agency, the Department of Health and Human Services. Contract costs on federal government contracts, including indirect costs, are subject to audit by the federal government and adjustments pursuant to negotiation between the Institute and government representatives. Revenue on federal government contracts has been recorded in amounts that are expected to be realized upon final settlement of the Institute's indirect rates. As of September 30, 2020, management believes that the final settlement of indirect rates will not have a material impact on the Institute's net assets, operations, or cash flows.

International Resources Group Ltd. (IRG) is a 100% owned subsidiary of the Institute and was acquired in 2017. IRG is required to separately negotiate final indirect cost rates with its cognizant federal agency, the United States Agency for International Development (USAID). IRG and USAID have negotiated and settled IRG's final indirect cost rates through fiscal year 2014. Final rates for fiscal years 2015 and 2016 have been audited, but will not be officially settled until the home office allocations from IRG's previous parent company are audited. Any contingencies arising from IRG's incurred cost audit matters through fiscal year 2016 are subject to indemnification up to the purchase price of IRG as stipulated in the purchase agreement. USAID's audit of IRG's fiscal year 2017 final rates concluded in September 2020 with no questioned costs or disclaimers related to home office allocations from RTI. USAID's audit of the fiscal year 2018 rates is in process and no audits for any subsequent years have been initiated.

\* \* \* \* \*

**FEDERAL AWARDS SUPPLEMENTAL INFORMATION AS OF AND FOR THE  
YEAR END SEPTEMBER 30, 2020**

## **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 Governors  
Research Triangle Institute:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Research Triangle Institute and its subsidiaries (the "Institute") as of and for the year ended September 30, 2020, and the related notes to the consolidated financial statements, which collectively comprise the Institute's consolidated financial statements, and have issued our report thereon dated December 10, 2020.

### **Internal Control Over Financial Reporting**

In planning and performing our audit of the consolidated financial statements, we considered the Institute's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Institute's internal control. Accordingly, we do not express an opinion on the effectiveness of the Institute's internal control.

*A deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Institute's consolidated financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the financial statements. 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*.

**Purpose of this Report**

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

A handwritten signature in black ink that reads "Deloitte & Touche LLP". The signature is written in a cursive, flowing style.

December 10, 2020

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR  
FEDERAL PROGRAM; REPORT ON INTERNAL CONTROL OVER COMPLIANCE;  
AND REPORT ON SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
REQUIRED BY THE UNIFORM GUIDANCE**

To the Board of Governors  
Research Triangle Institute:

**Report on Compliance for Each Major Federal Program**

We have audited Research Triangle Institute and its subsidiaries' (the "Institute") compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of the Institute's major federal programs for the year ended September 30, 2020. The Institute's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

The Institute's consolidated financial statements include the operations of International Resources Group Ltd. ("IRG"). IRG's revenues for the year ended September 30, 2020 include \$14.5 million from one contract that was awarded under the Federal Acquisition Regulation. Our audit, described below, did not include this one IRG contract because the related contract expenditures are not included in the Institute's schedule of expenditures of federal awards for the year ended September 30, 2020 as described in Note 2 to the schedule of expenditures of federal awards.

**Management's Responsibility**

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

**Auditor's Responsibility**

Our responsibility is to express an opinion on compliance for each of the Institute's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Institute's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the Institute's compliance.

### **Opinion on Each Major Federal Program**

In our opinion, the Institute complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended September 30, 2020.

### **Report on Internal Control Over Compliance**

Management of the Institute is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Institute's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Institute's internal control over compliance.

*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

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

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



## **Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance**

We have audited the consolidated financial statements of the Institute as of and for the year ended September 30, 2020, and have issued our report thereon dated December 10, 2020, which contained an unmodified opinion on those consolidated financial statements. Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the Uniform Guidance and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

A handwritten signature in black ink that reads "Deloitte & Touche LLP". The signature is written in a cursive, flowing style.

May 19, 2021

# RESEARCH TRIANGLE INSTITUTE

## NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS FOR THE YEAR ENDED SEPTEMBER 30, 2020

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### 1. BASIS OF PRESENTATION

The schedule of expenditures of federal awards (the “SEFA”) includes the federal award activity of the Research Triangle Institute (the “Institute”) under programs of the federal government for the year ended September 30, 2020. The information in the SEFA is presented in accordance with the requirements of Title 2 U.S. Code of Federal Regulations (“2 CFR”) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Because the SEFA presents only a selected portion of the operations of the Institute, it is not intended to and does not present the financial position, changes in net assets, or cash flows of the Institute.

Assistance listing numbers (“CFDA numbers”) are unique numbers assigned to identify Federal Assistance Listings, the publicly available listing of Federal assistance programs managed and administered by the General Services Administration, formerly known as the Catalog of Federal Domestic Assistance. As provided for in Uniform Guidance, when no CFDA number is assigned, the purpose of federal contracts from the same federal agency is assessed, and those made for the same purpose are combined and considered one program. Programs without a CFDA number are presented with only the federal agency’s two-digit prefix followed by the abbreviation “RD” for those programs in the research and development cluster or “U” (i.e. unknown) and sequentially numbered by federal agency in place of a CFDA number. The Institute assigns sequential numbers on an annual basis, accordingly, programs that extend over multiple years may have a different assigned number each year. The federal agency two-digit prefixes are as follows:

Prefix	Federal Agency
10	Department of Agriculture
11	Department of Commerce
12	Department of Defense
14	Department of Housing and Urban Development
15	Department of the Interior
16	Department of Justice
17	Department of Labor
19	Department of State
20	Department of Transportation
43	National Aeronautics & Space Administration
45	National Endowment for the Arts & Humanities
47	National Science Foundation
66	Environmental Protection Agency
81	Department of Energy
84	Department of Education
85	Scholarship Foundations
93	Department of Health and Human Services
97	Department of Homeland Security
98	U.S. Agency for International Development
99	Miscellaneous

## **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The SEFA has been prepared in accordance with the accrual basis of accounting and with accounting principles generally accepted in the United States of America, and is consistent with the preparation of the Institute's consolidated financial statements. Amounts reflected in the SEFA include only expenditures of federal awards whereas the corresponding amounts reported in the consolidated financial statements also include expenditures of federal fixed price contracts and nonfederal awards. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Negative amounts shown on the SEFA represent adjustments or credits made in the normal course of business to amounts reported as expenditures in prior years.

An award is considered expended when the activity related to the award occurs. The activity generally pertains to events requiring compliance with laws, regulations, and the provisions of contract and grant agreements. Direct costs have been recognized on the accrual basis of accounting when costs are incurred. For time and materials contracts, expenditures are recognized as hours and costs are incurred based on negotiated rates. Fees on cost-plus contracts are recognized as costs are incurred and expenditures include a proportionate share of the fees earned.

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The consolidated financial statements include the accounts of the Institute and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated.

The preparation of the consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the consolidated financial statements. Actual results could differ from those estimates.

The Institute's consolidated financial statements include the results of operations of International Resources Group Ltd. ("IRG"), a for-profit corporation, acquired on January 6, 2017. After the acquisition, IRG continued to be the prime contractor on contracts originally awarded under the *Federal Acquisition Regulation* prior to the acquisition date through September 30, 2017. Effective October 1, 2017, all but one of these contracts were novated to the Institute to be the prime contractor. The expenditures related to these novated contracts are included in the Institute's SEFA for the year ended September 30, 2020. The one remaining IRG contract that was not novated had approximately \$14.5 million in revenues for the year ended September 30, 2020. The Institute determined this contract did not meet the definition of a federal award as IRG is not a nonfederal entity, as defined in Uniform Guidance. Therefore, the corresponding expenditures incurred during the period related to this contract are not included in the Institute's SEFA for the year ended September 30, 2020.

## **3. INDIRECT COST RATE**

The Institute has elected not to use the 10-percent de minimis indirect cost rate allowed under the Uniform Guidance. Indirect costs are recovered from the federal government by applying a federally negotiated indirect cost rate or by allocating these costs among benefiting programs in accordance with a federally approved plan. Each program's share of indirect costs is recognized on the accompanying SEFA.

#### **4. RELATIONSHIP TO FEDERAL FINANCIAL REPORTS**

The regulations and guidelines governing the preparation of federal financial reports vary by federal agency and among programs administered by the same agency. Accordingly, the amounts reported in the federal financial reports do not necessarily agree with the amounts reported in the accompanying SEFA, which is prepared as explained in Notes 1 and 2 above.

#### **5. SUBRECIPIENTS**

Uniform Guidance defines a subrecipient as a nonfederal entity that receives a subaward from a pass-through entity to carry out part of a federal program but does not include an individual who is a beneficiary of such program or payments to a contractor. A contractor is an entity that receives a contract by which a nonfederal entity purchases property or services needed to carry out the project or program under a federal award. A nonfederal entity may concurrently receive federal funds as a recipient, subrecipient, and contractor, depending on the substance of its agreements with federal awarding agencies and pass-through entities. Therefore, the Institute must make case-by-case determinations whether each agreement it makes for the disbursement of federal program funds casts the party receiving the funds as a subrecipient or a contractor based on the Uniform Guidance definitions and management's judgement. The total amount identified as provided to subrecipients during the year ended September 30, 2020 was \$42,377,269.

# RESEARCH TRIANGLE INSTITUTE

## SCHEDULE OF FINDINGS AND QUESTIONED COSTS FOR THE YEAR ENDED SEPTEMBER 30, 2020

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### Section I—Summary of Auditors' Results

#### FINANCIAL STATEMENTS:

Type of report the auditor issued on whether the financial statements audited were prepared in accordance with GAAP: Unmodified

Internal control over financial reporting:

Material weakness(es) identified? ☐ Yes ☒ No

Significant deficiency(ies) identified? ☐ Yes ☒ None Reported

Noncompliance material to financial statements noted? ☐ Yes ☒ No

#### FEDERAL AWARDS:

Internal control over major federal programs:

Material weakness(es) identified? ☐ Yes ☒ No

Significant deficiency(ies) identified? ☐ Yes ☒ None Reported

Type of auditor's report issued on compliance for major federal programs: Unmodified

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

Identification of major federal programs:

**CFDA**

**Number    Name of federal program, cluster, or contract**

**Type A**

93.778	MEDICAID CLUSTER
98.001	USAID FOREIGN ASSISTANCE FOR PROGRAMS OVERSEAS
98.U24	TUSOME – EARLY GRADE READING PROGRAM IN KENYA
98.U38	POWER AFRICA EAST AFRICA ENERGY PROGRAM POWER AFRICA OFF-GRID PROGRAM
98.U51	ARITHMETIC AND INCLUSIVE EDUCATION (AIE) ACTIVITY

Dollar threshold used to distinguish between type A and type B programs:

\$3,000,000

Auditee qualified as low-risk auditee?

  X   Yes

       No

**Section II—Financial Statement Findings**

None identified.

**Section III—Federal Award Findings and Questioned Costs**

None identified.

## **RESEARCH TRIANGLE INSTITUTE**

### **SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS FOR THE YEAR ENDED SEPTEMBER 30, 2020**

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No audit findings reported in prior year.