



Report of Independent Auditors and
Financial Statements with
OMB Circular A-133 Audit Reports and
Supplementary Information

**Palo Alto Veterans Institute
for Research**

September 30, 2014

MOSS ADAMS LLP

Certified Public Accountants | Business Consultants

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REPORT OF INDEPENDENT AUDITORS

To the Board of Directors
Palo Alto Veterans Institute for Research

Report on the Financial Statements

We have audited the accompanying financial statements of Palo Alto Veterans Institute for Research (the "Organization"), which comprise the statement of financial position as of September 30, 2014, and the related statements of activities, functional expenses, and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *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 financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Organization's preparation and fair presentation of the 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 Organization'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 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 financial statements referred to above present fairly, in all material respects, the financial position of Palo Alto Veterans Institute for Research as of September 30, 2014, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of expenditures of federal awards as required by Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated January 23, 2015, on our consideration of the Organization'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 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 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 Organization's internal control over financial reporting and compliance.

A handwritten signature in cursive script that reads "Mass Adams LLP".

San Francisco, California
January 23, 2015

FINANCIAL STATEMENTS

PALO ALTO VETERANS INSTITUTE FOR RESEARCH
STATEMENT OF FINANCIAL POSITION
As of September 30, 2014

ASSETS

CURRENT ASSETS

Cash and cash equivalents	\$	1,019,701
Certificates of deposit		3,448,237
Accounts receivable		3,111,896
Prepaid expenses		55,085

Total current assets 7,634,919

CERTIFICATES OF DEPOSIT - long-term

119,886

EQUIPMENT, net

866,427

Total assets

\$ 8,621,232

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES

Accounts payable	\$	601,558
Payroll payable		563,999
Accrued vacation		597,222
Other accrued liabilities		337,286
Deferred revenue		859,922

Total current liabilities 2,959,987

NET ASSETS

Unrestricted		
Board-designated		1,360,000
Undesignated		3,455,714

Total unrestricted 4,815,714

Temporarily restricted 845,531

Total net assets 5,661,245

Total liabilities and net assets \$ 8,621,232

See accompanying notes.

PALO ALTO VETERANS INSTITUTE FOR RESEARCH
STATEMENT OF ACTIVITIES
For the Year Ended September 30, 2014

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
REVENUE AND OTHER SUPPORT			
Federal award revenue	\$ 17,698,853	\$ -	\$ 17,698,853
Other program revenue	4,776,340	1,755,966	6,532,306
Interest income	17,978	-	17,978
Unrealized gain on certificates of deposit	1,891	-	1,891
Total revenue	<u>22,495,062</u>	<u>1,755,966</u>	<u>24,251,028</u>
NET ASSETS RELEASED FROM RESTRICTIONS			
Satisfaction of program restrictions	<u>1,532,373</u>	<u>(1,532,373)</u>	<u>-</u>
Total revenue and other support	<u>24,027,435</u>	<u>223,593</u>	<u>24,251,028</u>
EXPENSES			
Program expenses	18,750,167	-	18,750,167
Management and general expenses	<u>5,559,488</u>	<u>-</u>	<u>5,559,488</u>
Total expenses	<u>24,309,655</u>	<u>-</u>	<u>24,309,655</u>
Change in net assets	(282,220)	223,593	(58,627)
NET ASSETS, at beginning of year	<u>5,097,934</u>	<u>621,938</u>	<u>5,719,872</u>
NET ASSETS, at end of year	<u>\$ 4,815,714</u>	<u>\$ 845,531</u>	<u>\$ 5,661,245</u>

See accompanying notes.

PALO ALTO VETERANS INSTITUTE FOR RESEARCH
STATEMENT OF FUNCTIONAL EXPENSES
For the Year Ended September 30, 2014

	<u>Program</u>	<u>Management and General</u>	<u>Total</u>
Personnel costs	\$ 12,118,431	\$ 2,998,632	\$ 15,117,063
Supplies	2,567,742	283,647	2,851,389
Outside services	1,455,813	486,909	1,942,722
Subawards	1,580,255	-	1,580,255
Computer maintenance and supplies	81,354	564,129	645,483
Comparative medicine	488,772	-	488,772
Travel	94,739	231,180	325,919
Maintenance and repairs	12,690	233,516	246,206
Depreciation	-	227,531	227,531
Small equipment	102,977	65,470	168,447
Professional fees	-	148,625	148,625
Meetings and conferences	38,340	89,645	127,985
Subject payments	119,440	2,317	121,757
Office supplies	3,358	70,074	73,432
Printing and publication	26,012	41,762	67,774
Dues and subscriptions	3,788	40,001	43,789
Insurance	-	38,189	38,189
Postage and delivery	15,925	16,296	32,221
Subject recruitment	22,608	-	22,608
VA Services	16,640	-	16,640
Telecommunications	523	9,215	9,738
Books	760	7,313	8,073
Bad debts	-	2,900	2,900
Misc. Expense	-	2,137	2,137
Totals	<u>\$ 18,750,167</u>	<u>\$ 5,559,488</u>	<u>\$ 24,309,655</u>

See accompanying notes.

PALO ALTO VETERANS INSTITUTE FOR RESEARCH
STATEMENT OF CASH FLOWS
For the Year Ended September 30, 2014

CASH FLOWS FROM OPERATING ACTIVITIES

Change in net assets	\$ (58,627)
Adjustments to reconcile change in net assets to net cash from operating activities:	
Depreciation	227,531
Unrealized gain on certificates of deposit	(1,891)
Change in operating assets:	
Accounts receivable	(526,991)
Prepaid expenses	47,232
Change in operating liabilities:	
Accounts payable	330,885
Payroll payable	49,152
Accrued vacation	90,406
Other accrued liabilities	(159,173)
Deferred revenue	180,321
Total adjustments	<u>237,472</u>
Net cash from operating activities	<u>178,845</u>

CASH FLOWS USED IN INVESTING ACTIVITIES

Purchases of equipment	(325,677)
Purchases of certificate of deposits	(3,875,000)
Proceeds from sales of certificates of deposit	<u>3,442,590</u>
Net cash used in investing activities	<u>(758,087)</u>
Net change in cash and cash equivalents	(579,242)

CASH AND CASH EQUIVALENTS, beginning of year

1,598,943

CASH AND CASH EQUIVALENTS, end of year

\$ 1,019,701

PALO ALTO VETERANS INSTITUTE FOR RESEARCH

NOTES TO FINANCIAL STATEMENTS

NOTE 1 – GENERAL DESCRIPTION OF ACTIVITIES AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Palo Alto Veterans Institute for Research (the “Organization”), formerly known as Palo Alto Institute for Research and Education, Inc., was formed in 1988 as a research institute affiliated with the Department of Veterans Affairs Palo Alto Health Care System (“VA”) in Palo Alto, California, under the provisions of Public Law 100-322. The Organization works with sponsors and the VA in administering funds for conducting research to improve the health of veterans.

Income is derived primarily from conducting investigative projects sponsored by public and private organizations. The Organization receives government grants and contracts as well as awards from private corporations and philanthropic foundations to pursue health research goals.

Thanks to strong collaborative ties, the Organization works with a large community of uniquely talented medical researchers across a broad spectrum of research areas as the Organization fulfills its purpose of Driving Veterans Health Innovation. The range of research activities is broad and includes special emphasis on major diseases categories, all of which are prevalent in the VA’s patient population. These are:

Cardiovascular medicine

Cancer

Mental health – including Traumatic Brain Injury (“TBI”) and Post Traumatic Stress Disorder (“PTSD”)

In addition, the Organization is particularly interested in chronic inflammatory disease, and stem cell/regenerative medicine. A deeper understanding of chronic inflammatory disease, genetic, and other factors influencing veterans’ health can provide significant insight into the understanding of an individual’s health status. Ultimately, advances in genomics will make personalized medicine a reality.

Basis of presentation – The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (“GAAP”).

Use of estimates – The preparation of the financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates. The Organization utilizes estimates in its functional expenses, calculation of depreciation expense, and determination of certificates of deposit values.

Net asset classifications – Net assets, revenues, expenses, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the Organization and changes therein are classified and reported as follows:

Unrestricted net assets – Include those assets over which the Board of Directors has discretionary control in carrying out the operations of the Organization.

Temporarily restricted net assets – Net assets subject to donor-imposed restrictions that will be met either by actions of the Organization and/or the passage of time. When donor-stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

Permanently restricted net assets – Net assets that are subject to donor-imposed restrictions that specify assets donated be invested to provide a permanent source of income. There were no permanently restricted net assets as of September 30, 2014.

Revenue recognition – The Organization administers several different types of research agreements, including those that are reciprocal and nonreciprocal (charitable) in nature. Reciprocal agreements are typically on a per-subject payment schedule or milestones. Grant revenue is recognized when earned, generally in proportion to the expense incurred. Advance payments from sponsors are classified as deferred revenue and recognized as revenue upon expenditure of allowable costs or completion of the various stages of the studies.

**PALO ALTO VETERANS INSTITUTE FOR RESEARCH
NOTES TO FINANCIAL STATEMENTS**

Nonreciprocal revenues or contributions are reported as increases in restricted net assets if they are given with a donor-imposed restriction. Expiration of donor-imposed restrictions (i.e., the donor-stipulated purpose has been satisfied) is reported as satisfaction of program restrictions. The Organization reports donations as unrestricted revenue when the donor does not restrict its use as well as when the donor's restrictions are met in the same reporting period.

Other program revenue includes both grants and contracts from public and private sources. Revenue is recognized as unrestricted or temporarily restricted as specified by the donor, either when received, when costs are incurred or when milestones are reached based on the individual grant or contract provisions.

Cash and cash equivalents – The Organization considers short-term, highly liquid investments to be cash equivalents provided that they are both readily convertible to cash and had an original maturity of three months or less when purchased.

Certificates of deposit – Certificates of deposits are carried at fair value. The Organization has both the ability and the intent to hold them to maturity. Fair value is determined by discounting the related cash flows based on current yields of similar instruments with comparable durations considering the credit-worthiness of the issuer.

Accounts receivable – Accounts receivable are stated at the amount management expects to collect from outstanding balances after reserves for discounts, bad debts, and allowances, taking into account past experience, contracts, history and other organizations' ability to meet their obligations. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to expense and a reduction of accounts receivable. Management has deemed all accounts receivable fully collectible.

Equipment – Equipment is stated at cost. Depreciation is computed using the straight-line method with half-year convention over the assets' estimated useful lives ranging from three to seven years. The Organization has adopted a capitalization policy of capitalizing equipment purchases of \$5,000 or more.

Fair value of financial instruments – Unless otherwise indicated, the fair values of all reported assets and liabilities, which represent financial instruments, approximate their carrying values.

Accrued vacation – Accrued vacation represents vacation earned but not taken. The maximum vacation time that can be accrued is 240 hours. The accrued vacation balance as of September 30, 2014, was \$597,222.

Deferred revenue – The Organization receives advances for services to be performed in the future. The amounts are recorded as deferred revenue when received and are recognized as revenue when the services are provided.

Functional expenses allocation – All costs are charged directly to the appropriate functional expense category. There were no fundraising activities for the year ended September 30, 2014.

Income taxes – Palo Alto Veterans Institute for Research is a nonprofit corporation exempt from federal income tax under Internal Revenue Code section 501(c)(3) and state income tax under California Revenue and Taxation Code section 23701d. The Organization qualifies for the charitable contribution deduction under IRC section 170(b)(1)(A)(iii) and has been classified as an Organization that is not a private foundation under section 509(a)(1). As of September 30, 2014, the Organization had no unrecognized tax benefits or uncertain tax positions requiring accrual. Therefore, no provision for income taxes has been provided in the financial statements. With few exceptions, the Organization is no longer subject to the United States federal or state local income tax examinations by tax authorities for fiscal years before 2009.

NOTE 2 – EQUIPMENT

Equipment is comprised of the following as of September 30, 2014:

Medical research assets	\$ 1,617,102
Administrative assets	664,289
Less accumulated depreciation	<u>(1,414,964)</u>
Equipment, net	<u>\$ 866,427</u>

Depreciation expense for the year ended September 30, 2014, was \$227,531.

PALO ALTO VETERANS INSTITUTE FOR RESEARCH
NOTES TO FINANCIAL STATEMENTS

NOTE 3 – TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets as of September 30, 2014, are available for the following purposes:

Research restricted donations	\$	832,902
Educational activities		<u>12,629</u>
Total	\$	<u><u>845,531</u></u>

Net assets were released from donor restrictions during the year ended September 30, 2014, by incurring expenses to satisfy the purpose of the restriction, by the passage of time, or by the occurrence of other specific events as shown in the table below:

Research restricted donations	\$	1,523,893
Educational activities		<u>8,480</u>
Total	\$	<u><u>1,532,373</u></u>

NOTE 4 – RETIREMENT PLAN

The Organization’s retirement plan (under Internal Revenue Code section 401(k)) includes a defined contribution retirement plan (of the profit-sharing type) and a cash or deferred arrangement. As of March 1, 2014, all employees are eligible for the plan. Prior to March 1, 2014, temporary employees were not eligible. At the time, a temporary employee was defined as an employee hired to work for twelve months or less. Eligible employees may elect to defer a percentage of their salary into the plan. After one year of service, the Organization matches participants’ contributions up to 5% of the individual participant’s compensation. Additionally, the Organization makes annual profit-sharing contributions of up to 5% of eligible employee compensation. Postdoctoral Fellows hired after January 1, 2008 are not eligible for the match or profit-sharing contributions. Contributions made to the plan by the Organization were \$615,824 for the year ended September 30, 2014. Plan assets are not reflected in the accompanying financial statements.

NOTE 5 – RELATED PARTY TRANSACTIONS

In 1988, the Organization was incorporated in the State of California in accordance with Title 38 of the United States Code Chapter 73 Subchapter VI-Research Corporations, as established by Public Law 100-322. The Organization provides a flexible funding mechanism for the conduct of approved research at the VA Palo Alto Health Care System (“VAPAHCS”). Furthermore, as stipulated by statute, the persons holding the positions of Director, Chief of Staff, Associate Chief of Staff for Research and Development and Associate Chief of Staff for Education of VAPAHCS shall be permanent board members of the Organization.

The majority of the Organization’s board of directors are employed or affiliated with the VA. The Organization reimburses the VA for various services. Expenses incurred for services received from the VA were approximately \$258,842 for the fiscal year.

Additionally, the Organization charges the VA for some personnel costs via the Intergovernmental Personnel Act (“IPA”) of 1970. Costs expended include salaries and wages, as well as payroll taxes and other benefit costs. Reimbursements for these costs were approximately \$2,419,259 for the year ended September 30, 2014. These costs were included in personnel costs on the statement of functional expenses. At September 30, 2014, the VA was indebted to the Organization in the amount of \$481,388. The VA provides office space and utilities to the Organization at no cost.

NOTE 6 – CONCENTRATIONS

Major funding

During the year ended September 30, 2014, the Organization received approximately 64% of its revenue from the U.S. Department of Health & Human Services National Institutes of Health. The Organization has long-term agreements with the federal agency and does not anticipate a decrease in funding from these sources.

PALO ALTO VETERANS INSTITUTE FOR RESEARCH
NOTES TO FINANCIAL STATEMENTS

As of September 30, 2014, the Organization had receivables from the U.S. Department of Health and Human Services National Institutes of Health of \$1,532,020, or 49% of total accounts receivable as of September 30, 2014; Stanford University of \$428,520, or 14% of total accounts receivable as of September 30, 2014; and the VA of \$481,388, or 15% of total accounts receivable as of September 30, 2014.

Major vendor – The Organization incurred expenses from one vendor for the year ended September 30, 2014, of \$2,517,131, or 13.4% of program expenses as of September 30, 2014.

NOTE 7 – COMMITMENTS AND CONTINGENCIES

The Organization has received federal grants for specific purposes that are subject to review and audit by the federal government. Although such audits could result in expenditure disallowances under grant terms, management believes the Organization is in substantial compliance with current laws and regulations and that any potential liability arising from compliance issues will not be material to the Organization’s financial position and changes in net assets as of and for the year ended September 30, 2014.

Board designated funds – The Organization’s Board has designated \$1,360,000 of unrestricted net assets, which are not to be spent without specific board approval.

NOTE 8 – FAIR VALUE MEASUREMENT

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value hierarchy requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

- Level 1* Quoted prices in active markets for identical assets or liabilities
- Level 2* Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities
- Level 3* Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

Where quoted market prices are available in an active market, investments are classified within Level 1 of the valuation hierarchy. Level 1 investments include highly liquid government bonds and exchange traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of investments with similar characteristics or discounted cash flows. Level 2 investments include most fixed income investments traded in a limited market and certificates of deposit. In certain cases where Level 1 or Level 2 inputs are not available, investments are classified within Level 3 of the hierarchy.

The following table presents the fair value measurements of assets recognized in the accompanying statement of financial position measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at September 30, 2014:

Description	Level 1	Level 2	Level 3	Total
Certificates of deposit	\$ -	\$ 3,568,123	\$ -	\$ 3,568,123

PALO ALTO VETERANS INSTITUTE FOR RESEARCH
NOTES TO FINANCIAL STATEMENTS

NOTE 9 – SUBSEQUENT EVENTS

Subsequent events are events or transactions that occur after the statement of financial position date but before financial statements are issued. The Organization recognizes in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the statement of financial position, including the estimates inherent in the process of preparing the financial statements. The Organization's financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the statement of financial position but arose after the statement of financial position date and before financial statements are available to be issued.

The Organization has evaluated subsequent events through January 23, 2015, which is the date the financial statements are available to be issued.

SUPPLEMENTARY INFORMATION

PALO ALTO VETERANS INSTITUTE FOR RESEARCH
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Year Ended September 30, 2014

Federal Grantor/Pass-Through Grantor/Program or Cluster Title	Federal CFDA Number (*)	Pass-Through Entity Identifying Number	Federal Expenditures
<i>Research and Development Cluster</i>			
U.S. Department of Defense:			
Basic and Applied Scientific Research	12.300		\$ 130,759
Military Medical Research and Development	12.420		<u>727,950</u>
Subtotal Direct Programs			<u>858,709</u>
Pass-through programs from:			
Department of Veterans Affairs - Military Medical Research and Development		VA798-12-X-0042	\$ 363,702
HM Jackson Foundation - Military Medical Research and Development		W91Y TZ-11-C-0033	240,738
General Dynamics Information Technology - Military Medical Research and Development		W91Y TZ-13-C-0015	390,510
University of Minnesota - Military Medical Research and Development	12.420	W81XWH-12-1-0619	4,583
University of Southern California - Military Medical Research and Development	12.420	W81XWH-10-2-0076	3,458
University of California, San Francisco - Military Medical Research and Development	12.420	W81XWH-13-1-0297	27,286
Craig Hospital - Military Medical Research and Development	12.420	W81XWH-11-1-0635	100,133
Stanford University - Military Medical Research and Development	12.420	W81XWH-12-1-0557	21,921
University of Colorado - Military Medical Research and Development	12.420	W81XWH-13-1-0408	60,712
University of California, San Diego - Military Medical Research and Development	12.420	W81 XWH-13-2-009	<u>3,525</u>
Subtotal pass-through programs			<u>1,216,568</u>
Total U.S. Department of Defense			<u>2,075,277</u>
National Aeronautics and Space Administration			
Pass-through programs from:			
University of California, San Francisco - Engineering Grants	47.041	NNX14AC94G	<u>78,717</u>
Total National Science Foundation			<u>78,717</u>
U.S. Department of Education			
Pass-through programs from:			
Smith-Kettlewell Eye Research Insitute - Rehabilitation Engineering Research Centers	84.133	H133E110004	<u>15,125</u>
Total U.S. Department of Education			<u>15,125</u>
U.S. Department of Health and Human Services:			
Oral Diseases and Disorders Research	93.121		364,922
Research and Training in Complementary and Alternative Medicine	93.213		439,034
National Center on Sleep Disorders Research	93.233		311,061
Mental Health Research Grants	93.242		2,174,464
Alcohol Research Programs	93.273		161,793
Drug Abuse and Addiction Research Programs	93.279		166,693
Minority Health and Health Disparities Research	93.307		343,547
Trans-NIH Research Support	93.310		630,505
Cancer Cause and Prevention Research	93.393		31,172
Cancer Biology Research	93.396		508,160
Cardiovascular Diseases Research	93.837		783,737
Lung Diseases Research	93.838		189,483
Blood Diseases and Resources Research	93.839		202,545
Arthritis, Musculoskeletal and Skin Diseases Research	93.846		370,951
Diabetes, Digestive, and Kidney Diseases Extramural Research	93.847		189,547
Extramural Research Programs in the Neurosciences and Neurological Disorders	93.853		1,769,529
Allergy, Immunology and Transplantation Research	93.855		2,164,598
Biomedical Research and Research Training	93.859		328,287
Aging Research	93.866		<u>1,348,075</u>
Subtotal Direct Programs			<u>12,478,103</u>

(*) CFDA numbers that are not available were intentionally left blank

PALO ALTO INSTITUTE FOR RESEARCH AND EDUCATION
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Year Ended September 30, 2014

Federal Grantor/Pass-Through Grantor/Program or Cluster Title	Federal CFDA Number (*)	Pass-Through Entity Identifying Number	Federal Expenditures
Pass-through programs from:			
Stanford University - National Heart, Lung and Blood Institute Contract		HHSN26820101134C	19,996
UCSF-Center for Disease Control-National Health & Nutrition Examination Survey		200-2011-38445	9,987
Atlanta Research and Education Foundation - CDC Research			56,887
Brandeis University - Drug Abuse and Addiction Research Programs	93.279	R01 DA030150	4,968
University of Michigan - Nursing Research	93.361	R01 NR012011	88
ARRA - Stanford University - Trans-NIH Recovery Act Research Support	93.701	various	462,233
ARRA - University of Texas - Strategic Health IT Advanced Research Projects (SHARP)	93.728	90TR0004-01	1,687
Stanford University - Cardiovascular Diseases Research	93.837	UM1 HL113456	33,305
Vanderbilt University - Cardiovascular Diseases Research	93.837	P01 HL058000	139,040
Stanford University - Lung Diseases Research	93.838	P01 HL108797	401,163
UCSF - Diabetes, Digestive, and Kidney Diseases Extramural Research	93.847	R01 DK080123	41,333
Cleveland Clinic Lerner Center - Diabetes, Digestive, and Kidney Diseases Extramural Research	93.847	U01 DK066597	9,659
NCIRE - Diabetes, Digestive, and Kidney Diseases Extramural Research	93.847	R01 DK069406	83,864
Brigham & Women's - Extramural Research Programs in the Neurosciences & Neurological	93.853	R01 NS030843	52,005
UCSF - Extramural Research Programs in the Neurosciences & Neurological Disorders	93.853	R01 NS63008	10,889
SRI - Allergy, Immunology and Transplantation Research	93.855	R21 AI098658	66,485
Emory University - Allergy, Immunology and Transplantation Research	93.855	U19 AI057266	298,184
Mayo Clinic - Allergy, Immunology and Transplantation Research	93.855	various	285,814
UCSF - Allergy, Immunology and Transplantation Research	93.855	R01 AI073737	5,269
Stanford University - Microbiology and Infectious Diseases Research	93.856	U19 AI057229	312,210
Washington University in St. Louis - Child Health and Human Development Extramural Research	93.865	R01 HD068479	219,266
Northwestern University - Child Health and Human Development Extramural Research	93.865	R01 HD039343	29,661
University of Kentucky - Child Health and Human Development Extramural Research	93.865	R01 HD064993	28,920
University of Maryland, Baltimore - Aging Research	93.866	R01 AG037120	80,045
Stanford - Aging Research	93.866	P01 AG036695	371,593
John Hopkins University - Aging Research	93.866	R01 AG031348	9,712
Subtotal pass-through programs			<u>3,034,263</u>
Total U.S. Department of Health and Human Services			<u>15,512,366</u>
Total Research and Development Cluster and Expenditures of Federal Awards			<u>\$17,681,485</u>

(*) CFDA numbers that are not available were intentionally left blank

PALO ALTO VETERANS INSTITUTE FOR RESEARCH
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Year Ended September 30, 2014

NOTE 1 – BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal Awards (the “Schedule”) includes the federal grant activity of Palo Alto Veterans Institute for Research (the “Organization”), under programs of the federal government for the year ended September 30, 2014. The information in this schedule is presented in accordance with the requirements of the Office of Management and Budget (“OMB”) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Because the schedule presents only a selected portion of the operations of Palo Alto Veterans Institute for Research, Inc., it is not intended to and does not present the financial position, changes in net assets, or cash flows of the Organization.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in OMB Circular A-122, *Cost Principles for Non-Profit Organizations*, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Pass-through entity identifying numbers are presented where available.

NOTE 3 – SUBRECIPIENTS

Certain funds are passed through to subrecipient organizations by the Organization. Expenditures incurred by the subrecipients, and reimbursed by the Organization, are included in the Schedule of Expenditures of Federal Awards. Of the federal expenditures presented in the Schedule of Expenditures of Federal Awards, the Organization provided federal awards to subrecipients as follows:

Program Title	Federal CFDA Number	Amount Provided
Military Medical Research and Development	12.420	\$ 29,969
Oral Diseases and Disorders Research	93.121	153,003
National Center on Sleep Disorders Research	93.233	7,594
Mental Health Research Grants	93.242	780,779
Drug Abuse and Addiction Research Programs	93.279	12,587
Minority Health and Health Disparities Research	93.307	50,392
Trans-NIH Research Support	93.310	5,512
ARRA - Strategic Health IT Advanced Research Projects (SHARP)	93.728	(366)
Cardiovascular Diseases Research	93.837	6,804
Lung Diseases Research	93.838	10,715
Blood Diseases and Resources Research	93.839	(43)
Extramural Research Programs in the Neurosciences and Neurological Disorders	93.853	217,331
Allergy, Immunology, and Transplantation Research	93.855	134,375
Biomedical Research and Research Training	93.859	102,504
Aging Research	93.866	44,524
		<u>\$ 1,555,680</u>

REPORT OF INDEPENDENT AUDITORS ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Board of Directors
Palo Alto Veterans Institute for Research

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 Palo Alto Veterans Institute for Research (the "Organization") which comprise the statement of financial position as of September 30, 2014, and the related statements of activities, functional expenses, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated January 23, 2015.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Organization's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Organization's internal control. Accordingly, we do not express an opinion on the effectiveness of the Organization'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 Organization'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 Organization's 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 determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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 entity'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 Organization's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Mass Adams LLP

San Francisco, California
January 23, 2015

REPORT OF INDEPENDENT AUDITORS ON COMPLIANCE FOR THE MAJOR FEDERAL PROGRAM AND REPORT ON INTERNAL CONTROL OVER COMPLIANCE

To the Board of Directors
Palo Alto Veterans Institute for Research

Report on Compliance for the Major Federal Program

We have audited Palo Alto Veterans Institute for Research's (the "Organization") compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on the Organization's major federal program for the year ended September 30, 2014. The Organization's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for the Organization's major federal program 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 OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 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 the major federal program occurred. An audit includes examining, on a test basis, evidence about the Organization'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 the major federal program. However, our audit does not provide a legal determination on the Organization's compliance.

Opinion on the Major Federal Program

In our opinion, the Organization complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended September 30, 2014.

Report on Internal Control Over Compliance

Management of the Organization 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, we considered the Organization's internal control over compliance with the types of requirements that could have a direct and material effect on the major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for the major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, 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 Organization'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 OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

A handwritten signature in black ink that reads "Mass Adams LLP". The signature is written in a cursive, flowing style.

San Francisco, California
January 23, 2015

**PALO ALTO VETERANS INSTITUTE FOR RESEARCH
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For the Year Ended September 30, 2014**

Section I - Summary of Auditor's Results

Financial Statements

Type of auditor's report issued: *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 federal major programs:

- Material weakness(es) identified? Yes No
- Significant deficiency(ies) identified? Yes None reported

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133? Yes No

Identification of Federal Major Programs

<i>CFDA Numbers</i>	<i>Name of Federal Program or Cluster</i>	<i>Type of Auditor's Report Issued</i>
Various	Research and Development Cluster	<i>Unmodified</i>

Dollar threshold used to distinguish between type A and type B programs: \$530,445

Auditee qualified as low-risk auditee? Yes No

Section II - Financial Statement Findings

None noted

Section III - Federal Award Findings and Questioned Costs

None noted