# The Charles Stark Draper Laboratory, Inc.

## Report on State Awards in Accordance with State of Florida Rules of the Auditor General

June 29, 2012

# The Charles Stark Draper Laboratory, Inc.
## Summary of Reports
## June 29, 2012

**Report Title**

Report of Independent Auditors

Consolidated Financial Statements and Notes to Consolidated Financial Statements

Schedule of Expenditures of State Financial Assistance

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Schedule of Findings and Questioned Costs

## Report of Independent Auditors

To the Board of Directors of
The Charles Stark Draper Laboratory, Inc.:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of activities and changes in net assets, and cash flows present fairly, in all material respects, the financial position of The Charles Stark Draper Laboratory, Inc. and its subsidiaries (collectively referred to as the "Laboratory") at June 29, 2012 and July 1, 2011, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Laboratory's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 25, 2012, on our consideration of the Laboratory'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 for the year ended June 29, 2012. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The accompanying Schedule of Expenditures of State Financial Assistance for the year ended June 29, 2012 is presented for purposes of additional analysis as required by *Florida Single Audit Act,* Audits Nonprofits and For-Profits Organizations, Chapter 10.650, Rules of the Auditor General, and is not a required part of the basic consolidated financial statements. The 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 Schedule of Expenditures of State Financial Assistance 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 consolidated financial statements or 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 State Financial Assistance is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

PricewaterhouseCoopers LLP

September 25, 2012

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# The Charles Stark Draper Laboratory, Inc.
## Consolidated Balance Sheets
## June 29, 2012 and July 1, 2011

| | 2012 | 2011 |
|---|---|---|
| **Assets** | | |
| Current assets | | |
| Cash and cash equivalents | $ 46,898,012 | $ 35,602,979 |
| Accounts receivable - net of allowance of $573,112 and $424,988 in 2012 and 2011, respectively | 32,090,927 | 27,928,251 |
| Unbilled contract costs and fees, net of allowance of $553,879 and $463,563 in 2012 and 2011, respectively | 46,829,863 | 46,695,877 |
| Other current assets | 4,917,287 | 4,611,755 |
| Total current assets | 130,736,089 | 114,838,862 |
| Long-term investments | 167,556,950 | 162,212,018 |
| Deferred charges and other assets | 5,555,509 | 8,278,380 |
| Deferred financing costs, net | 570,461 | 601,863 |
| Prepaid pension benefits | 3,581,461 | 4,428,328 |
| Property and equipment, net | 188,845,275 | 189,223,000 |
| Total assets | $ 496,845,745 | $ 479,582,451 |
| **Liabilities and Net Assets** | | |
| Current liabilities | | |
| Accounts payable and accrued contract costs | $ 37,135,781 | $ 32,099,969 |
| Accrued compensation and related expenses | 23,785,366 | 20,532,631 |
| Other accrued expenses | 12,840,506 | 10,454,102 |
| Total current liabilities | 73,761,653 | 63,086,702 |
| Accrued post retirement benefits | 54,472,238 | 27,042,099 |
| Bonds payable, net | 79,182,924 | 79,128,791 |
| Deferred revenue and other long-term liabilities | 7,359,988 | 7,452,408 |
| Total liabilities | 214,776,803 | 176,710,000 |
| Commitments and contingencies | - | - |
| Unrestricted net assets | 282,068,942 | 302,872,451 |
| Total liabilities and net assets | $ 496,845,745 | $ 479,582,451 |

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

# The Charles Stark Draper Laboratory, Inc.
## Consolidated Statements of Activities and Changes in Net Assets
## Years Ended June 29, 2012 and July 1, 2011

| | 2012 | 2011 |
|---|---|---|
| **Operating revenues** | | |
| Net Revenue | $ 513,478,968 | $ 527,928,105 |
| Other income | 580,514 | 173,959 |
| Total operating revenues | 514,059,482 | 528,102,064 |
| **Operating expenses** | | |
| Direct costs | | |
| Subcontracts | 212,670,022 | 250,477,896 |
| Salaries and wages | 94,374,344 | 88,825,585 |
| Employee benefits | 26,109,208 | 25,113,408 |
| Materials, services and rentals | 19,622,345 | 19,047,801 |
| Other, principally travel and equipment | 27,171,763 | 24,614,853 |
| Total direct costs | 379,947,682 | 408,079,543 |
| Indirect costs | | |
| Salaries and wages | 55,494,086 | 57,577,400 |
| Employee benefits and vacations | 27,661,677 | 28,509,128 |
| Materials, services and rentals | 15,616,285 | 14,887,108 |
| Depreciation and amortization | 18,371,531 | 18,578,784 |
| Other | 13,628,149 | 7,096,432 |
| Total indirect costs | 130,771,728 | 126,648,852 |
| Interest expense and fees | 4,470,678 | 4,467,412 |
| Total operating expenses | 515,190,088 | 539,195,807 |
| Decrease in unrestricted net assets from operations | (1,130,606) | (11,093,743) |
| Non-operating gains/(losses) | | |
| Dividend and interest income | 1,527,484 | 1,536,486 |
| Realized and change in net unrealized gains/(losses) on long-term investments | 1,557,850 | 28,291,801 |
| Other non-operating income, net | 8,382,733 | 8,530,970 |
| Other changes in pension and post retirement benefits | (31,140,970) | 13,307,279 |
| Total non-operating (losses)/gains, net | (19,672,903) | 51,666,536 |
| (Decrease)/increase in unrestricted net assets | (20,803,509) | 40,572,793 |
| Unrestricted net assets, beginning of year | 302,872,451 | 262,299,658 |
| Unrestricted net assets, end of year | $ 282,068,942 | $ 302,872,451 |

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

# The Charles Stark Draper Laboratory, Inc.
## Consolidated Statements of Cash Flows
## Years Ended June 29, 2012 and July 1, 2011

| | | 2012 | | 2011 |
|---|---|---|---|---|
| **Cash flows from operating activities** | | | | |
| (Decrease)/increase in unrestricted net assets | $ | (20,803,509) | $ | 40,572,793 |
| Adjustments to reconcile change in unrestricted net assets to net cash provided by operating activities | | | | |
| Depreciation and amortization | | 18,371,531 | | 18,578,784 |
| Realized and net change in unrealized (gains)/losses on long-term investments | | (1,557,850) | | (28,291,801) |
| Other changes in pension and post retirement benefits | | 31,140,970 | | (13,307,279) |
| Loss/(gain) on disposal of property and equipment | | 35,440 | | (75,274) |
| Other non-cash adjustments | | (231,515) | | 88,010 |
| Changes in operating assets and liabilities | | | | |
| Accounts receivable | | (4,162,676) | | (4,011,602) |
| Unbilled contract costs and fees | | (133,985) | | 7,681,937 |
| Other current assets | | (305,532) | | (84,290) |
| Deferred charges and other assets | | 2,702,915 | | 19,475 |
| Accounts payable and accrued contract costs | | 5,035,811 | | (4,668,967) |
| Accrued compensation and related expenses | | 276,767 | | 2,740,949 |
| Deferred revenue | | 21,209 | | (692,803) |
| Other accrued expenses | | (814,694) | | 1,711,477 |
| Net cash provided by operating activities | | 29,574,882 | | 20,261,409 |
| **Cash flows from investing activities** | | | | |
| Additions to property and equipment | | (14,580,514) | | (12,503,923) |
| Proceeds from sale of property and equipment | | 23,194 | | 75,274 |
| Purchase of investment securities | | (37,324,130) | | (44,296,160) |
| Proceeds from sale of NTV investments | | 8,263 | | 38,762 |
| Proceeds from sale of investment securities | | 33,539,205 | | 40,594,919 |
| Net cash used in investing activities | | (18,333,982) | | (16,091,128) |
| **Cash flows from financing activities** | | | | |
| Change in bond discount | | 54,133 | | 51,238 |
| Net cash provided by financing activities | | 54,133 | | 51,238 |
| Net increase in cash and cash equivalents | | 11,295,033 | | 4,221,519 |
| Cash and cash equivalents, beginning of year | | 35,602,979 | | 31,381,460 |
| Cash and cash equivalents, end of year | $ | 46,898,012 | $ | 35,602,979 |
| **Supplemental disclosure of cash flow information** | | | | |
| Interest paid | $ | 4,219,306 | $ | 4,363,130 |
| Property and equipment included in accrued costs | | 3,486,628 | | - |

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

**1. Summary of Significant Accounting Policies**

**Corporate Organization and Purpose**

The Charles Stark Draper Laboratory, Inc. (The Laboratory) is a membership (nonstock), nonprofit Massachusetts Corporation. The Laboratory engages in activities that contribute to the support and advancement of scientific research, technology and development and in educational activities in the sciences and related subjects. The Laboratory's sponsors are primarily agencies of the U.S. Government.

In 2001, the Laboratory formed Navigator Technology Ventures (NTV), a majority-owned subsidiary. NTV was formed for the purpose of making the Laboratory's research and technology available for use by the general public through venture capital and technology transfer. NTV's results are fully consolidated in the financial statements of the Laboratory. All intercompany accounts are eliminated in consolidation. NTV was dissolved on September 30, 2010.

The Laboratory intends to continue to be exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code. In the event of either liquidation or dissolution of the Laboratory, its net assets would be distributed to one or more charitable tax-exempt organizations or governmental agencies.

**Fiscal Calendar**

The Laboratory's fiscal calendar (DFY) ends on the Friday closest to June 30$^{th}$. Due to this policy, the fiscal calendar may result in the last day of a fiscal year falling on a date other than on June 30. Approximately every fifth year the Laboratory's fiscal year will contain 53 weeks. There are 52 weeks in fiscal year 2012 and 52 weeks in fiscal year 2011.

**Capitalized Software**

Certain costs, as they relate to purchased hardware, software, and implementation activities have been capitalized in accordance with ASC 350-40, *Intangibles – Goodwill and Other – Internal-Use Software*.

**Revenue Recognition**

The Laboratory primarily performs research under cost-type contracts for its various sponsors. Under these contracts, reimbursement is received for direct and indirect contract costs plus a fixed or incentive fee. Costs are reimbursed and recognized as revenue as they are incurred. Contract fees are recognized in proportion to costs incurred as contracts are performed or otherwise as specified in the contract.

The Laboratory receives royalty payments in accordance with the terms of technology agreements. Royalty payments are recorded as other income in the statements of activities and changes in net assets.

**Net Assets**

The net assets of the Laboratory primarily consist of the excess of operating revenues over operating expenses since commencement of operations, the changes in gains and losses on investments and other non-operating income. All net assets are unrestricted in nature.

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

**Deferred Financing Costs**
The costs of securing financing are capitalized and amortized, on the straight-line method, over the life of the associated indebtedness. This method approximates the expense that would have been recognized using the effective interest method.

**Deferred Charges**
The Laboratory recovers overhead costs associated with U.S. Government-sponsored projects under construction in accordance with Cost Accounting Standards (CAS). As permitted under CAS, overhead costs associated with the development of software systems are recorded as deferred charges and amortized, on the straight-line method, over five years. In 2011 and prior, the Laboratory had elected to recognize the expense of the Supplemental Retirement Plan for Corporate Officers (SRPCO) over 15 years. In 2012, the Laboratory changed SRPCO methodology and expensed the balance of the deferred charges for retired officers. In future years, the Laboratory plans to expense any officer's paid charge in the year of retirement. The impact was $775,225 in the current year and had no affect on 2011.

**Property and Equipment**
Depreciation of owned equipment (including data processing equipment and software) is computed on the straight-line method using three- to five-year lives. Leasehold improvements are amortized on the straight-line method over the shorter of the useful lives of the assets or the lease term. Building costs are depreciated on the straight-line method over lives of thirty-nine to forty-two-years.

When assets are retired or otherwise disposed of, the assets and related allowances for depreciation and amortization are eliminated from the accounts and any resulting gain or loss is reflected in the statements of activities and changes in net assets.

In addition to the equipment and buildings acquired by the Laboratory and investments it makes in leasehold improvements, all of which are reflected in the accompanying balance sheets, the Laboratory also uses certain government-furnished equipment for which it is accountable to the U.S. Government.

**Independent Research**
The Laboratory engages in independent research programs authorized by its Board of Directors. The expenses of such programs are charged to operations as incurred.

**Cash and Cash Equivalents**
Cash and cash equivalents consist of amounts on hand and highly liquid investments with maturities of three months or less when purchased. The Laboratory maintains the majority of its cash and cash equivalents at one institution.

**Long-Term Investments**
Investments are primarily in equity securities and mutual funds with readily determinable fair values based on quoted market prices and collective trust funds. The fair value of the collective trust funds are based on net asset value (NAV) as determined by the investment company. Certain investments in debt securities are recorded at amortized cost as it is the Laboratory's intent to hold these investments until maturity. The investment goal for the various portfolios is capital preservation while generating returns sufficient to offset the impact of inflation. Realized gains and losses on investment securities are determined by the specific identification method. Dividends are recorded on the ex-dividend date and interest income is recorded on the accrual basis.

**New Accounting Pronouncement**
On July 2, 2011, The Laboratory adopted new guidance enhancing the *Fair Value Measurement* standard. This standard requires disclosure on the activity in the Level 3 rollforward to be reported on a gross, rather than net, basis.

## 2. Long-Term Investments

The Laboratory's long-term investment portfolio consists of the following at June 29, 2012 and July 1, 2011:

| | 2012 | 2011 |
|---|---|---|
| Investment securities | | |
| Cash and money market mutual funds | $ 695,488 | $ 981,128 |
| U.S. investment-grade fixed income funds | 59,120,870 | 54,546,630 |
| U.S. large cap equity holdings | 43,215,040 | 56,419,516 |
| U.S. small cap mutual fund | 20,410,088 | 8,229,850 |
| U.S. Treasury and fixed income holdings | 10,042,271 | 7,261,245 |
| Global equity funds | 33,516,075 | 34,356,288 |
| Insurance contracts and other | 403,537 | 342,603 |
| Total investment securities at fair value | 167,403,369 | 162,137,260 |
| Other investments | 153,581 | 74,758 |
| Total investment securities at amortized cost | 153,581 | 74,758 |
| Total long-term investments | $ 167,556,950 | $ 162,212,018 |

The following tables present information about the assets that are measured at fair value on a recurring basis as of June 29, 2012 and July 1, 2011, and indicate the fair value hierarchy of valuation techniques we utilized to determine such fair value.

| | June 29, 2012 | Level 1 Assets | Level 2 Assets | Level 3 Assets |
|---|---|---|---|---|
| Investment securities | | | | |
| Cash and money market mutual funds | $ 695,488 | $ 695,488 | $ - | $ - |
| U.S. investment-grade fixed income funds | 59,120,870 | - | 59,120,870 | - |
| U.S. large cap equity holdings | 43,215,040 | 43,215,040 | - | - |
| U.S. small cap mutual fund | 20,410,088 | 20,410,088 | - | - |
| U.S. Treasury and fixed income holdings | 10,042,271 | - | 10,042,271 | - |
| Global equity funds | 33,516,075 | 33,151,225 | 364,850 | - |
| Insurance contracts and other | 403,537 | - | 73,874 | 329,663 |
| | $ 167,403,369 | $ 97,471,841 | $ 69,601,865 | $ 329,663 |

| | July 1, 2011 | Level 1 Assets | Level 2 Assets | Level 3 Assets |
|---|---|---|---|---|
| Investment securities | | | | |
| Cash and money market mutual funds | $ 981,128 | $ 981,128 | $ - | $ - |
| U.S. investment-grade fixed income funds | 54,546,630 | - | 54,546,630 | - |
| U.S. large cap equity holdings | 56,419,516 | 56,419,516 | - | - |
| U.S. small cap mutual fund | 8,229,850 | 8,229,850 | - | - |
| U.S. Treasury and fixed income holdings | 7,261,245 | - | 7,261,245 | - |
| Global equity funds | 34,356,288 | 34,042,510 | 313,778 | - |
| Insurance contracts and other | 342,603 | - | 61,476 | 281,127 |
| | $ 162,137,260 | $ 99,673,004 | $ 62,183,129 | $ 281,127 |

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement data. In determining fair value, the use of various valuation approaches, including market, income and cost approaches, is permitted.

A fair value hierarchy has been established based on whether the inputs to valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from sources independent of the reporting entity and unobservable inputs reflect the entities' own assumptions about how market participants would value an asset or liability based on the best information available. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value.

In general, fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities. The Laboratory's Level 1 assets consist of equity holdings and mutual funds. Fair values determined by Level 2 inputs utilize data points that are observable, such as quoted prices, interest rates and yield curves. The Laboratory's Level 2 assets consist of variable annuities and a collective trust fund, all of which are recorded at the net asset value (NAV) provided by the investment company. The variable annuities are a component of the Laboratory's deferred compensation plan and there is an offsetting liability recorded on the accompanying balance sheets within short-term liabilities. The collective trust fund is comprised of investment-grade fixed income securities including U.S. Treasury and agency notes, corporate debt and mortgage-backed securities (primarily commercial mortgages).

Fair values determined by Level 3 inputs utilize unobservable data points for the asset or liability, and include situations where there is little, if any, observable market activity for the asset or liability. The Laboratory's Level 3 assets as of June 29, 2012 consist of insurance contracts associated with the deferred compensation plan discussed above. There are no liquidity restrictions associated with any of the Laboratory's investments recorded at fair value.

The change in the fair value of the Laboratory's investments with unobservable data points is shown below:

**Fair Value Measurements Using Significant Unobservable Inputs (Level 3)**

| | Insurance Contracts | Variable Annuities | Collective Trust | Total Investment Securities |
|---|---|---|---|---|
| **June 29, 2012** | | | | |
| Balance at beginning of year | $ 281,127 | $ - | $ - | $ 281,127 |
| Transfers to Level 2 | - | - | - | - |
| Unrealized appreciation of deferred compensation | 48,536 | - | - | 48,536 |
| Balance at end of year | $ 329,663 | $ - | $ - | $ 329,663 |
| **July 1, 2011** | | | | |
| Balance at beginning of year | $ 317,179 | $ - | $ - | $ 317,179 |
| Transfers to Level 2 | - | - | - | - |
| Unrealized depreciation of deferred compensation | (36,052) | - | - | (36,052) |
| Balance at end of year | $ 281,127 | $ - | $ - | $ 281,127 |

There were no unfunded commitments as of June 29, 2012. The Laboratory had no transfers from Level 2 to Level 1 in the current year.

## 3. Property and Equipment

Property and equipment are stated at cost. The following is a summary of property, plant and equipment, at cost less accumulated depreciation at June 29, 2012 and July 1, 2011:

| | 2012 | 2011 |
|---|---|---|
| Data processing equipment | $ 23,214,541 | $ 22,312,450 |
| Other equipment | 107,160,591 | 101,155,394 |
| Building and leasehold improvements | 54,262,973 | 51,267,969 |
| Building | 123,709,047 | 123,709,047 |
| Land | 32,984,487 | 32,984,487 |
| Construction in progress | 7,013,855 | 1,419,483 |
| | 348,345,494 | 332,848,830 |
| Less: Accumulated depreciation | 159,500,219 | 143,625,830 |
| Property and equipment, net | $ 188,845,275 | $ 189,223,000 |

Depreciation expense was $18,196,500, and $18, 346,985, for the years ended June 29, 2012 and July 1, 2011, while amortization expense was $175,031 and $231,799, for the years ended June 29, 2012 and July 1, 2011, respectively. The Laboratory capitalizes interest cost incurred during the the period of construction of capital assets. Interest costs capitalized during the years ended June 29, 2012 and July 1, 2011 were $211,870, and $65,152, respectively.

In December 2008, the Laboratory purchased a facility in St. Petersburg, Florida at a total cost of $7,931,895. Certain costs to fit-out this location, as well as costs incurred to fit-out a leased facility at the University of South Florida in Tampa, Florida were recorded in construction in progress in 2009 and were placed into service in 2010. In addition, the Laboratory entered into a contract with Hillsborough County, Florida, wherein the County has agreed to fund $976,000 of rent obligations pursuant to a ten year lease with the University of South Florida. The rent subsidies are stipulated to fund the rent obligations due in years 4 and 5 of the rental agreement (see Note 11). This pledge for future benefits has been classified as deferred charges on the balance sheets and will be recognized into revenue during years 4 and 5 of the lease. Fiscal year 2012, includes 6 months of year 4 lease, therefore the Laboratory recognized $240,400 of this deferred charge.

In December 2006, the Laboratory completed an addition to the Hill Building at a total cost of $64,383,119. The Hill Building and addition together comprise the One Hampshire at Kendall Square Condominium. In total, the Laboratory has leased 77.5% of the space available in the combined Hill Building and addition. The Laboratory occupies the remainder of this space. Rental income, including parking revenue, included within other non-operating income in the statement of activities and changes in net assets was $8,823,666 and $8,865,124 for the years ended June 29, 2012 and July 1, 2011, respectively. In addition, the Laboratory incurred $1,852,212 and $2,369,940 for its share of common area maintenance costs for the year ended June 29, 2012 and July 1, 2011, respectively. Generally accepted accounting principles require lease income to be recognized on a straight-line basis, which differs from the timing of rental payments in certain of the Laboratory's lease agreements. Revenue recorded in advance of rental payments was $2,890,207 as of June 29, 2012 and is included in deferred charges and other assets in the accompanying balance sheet. Minimum future rental payments on noncancelable leases to be received as of June 29, 2012 are as follows:

| **Year** | |
|---|---|
| 2013 | $ 6,315,093 |
| 2014 | 3,764,596 |
| 2015 | 3,562,754 |
| 2016 | 3,562,754 |
| 2017 | 3,752,583 |
| Thereafter | 37,449,431 |
| | $ 58,407,211 |

## 4. Capital Facilities Allowances and Unreimbursable Expenses

Capital facilities allowances of $3,145,044 in 2012 and $4,235,401 in 2011 are included in the statements of activities and changes in net assets.

During 2012 and 2011, certain expenses were either subsidized by the Laboratory or were not reimbursed under the terms of the Laboratory's contracts with its various sponsors . Total unreimbursed expenses included in indirect costs were $9,639,958 and $5,032,542 for 2012 and 2011, respectively, and consist principally of otherwise allowable overhead costs as well as unallowable personnel related and administrative expenses and charges incurred in excess of funded contract amounts. Total Laboratory funded projects and cost sharing was approximately $1,096,000 and $1,007,000 in 2012 and 2011, respectively.

## 5. Commitments and Contingencies

The Laboratory leases office space, laboratory facilities and certain equipment. Such leases expire at various dates through the year 2022, with options to extend for additional periods. The office space and laboratory facility lease payments are subject to escalation for increases in real estate taxes and operating expenses. Certain equipment is also rented on a short-term basis and charged to contracts. Total rental expense (exclusive of certain equipment rentals which are charged directly to contracts) was $1,833,760 and $1,412,298 in 2012 and 2011, respectively.

Minimum annual rental commitments under such leases (subject to certain escalation provisions) are as follows:

| Year | Building | Equipment | Total |
|---|---|---|---|
| 2013 | $ 1,448,371 | $ 259,257 | $ 1,707,628 |
| 2014 | 1,252,622 | 190,422 | 1,443,044 |
| 2015 | 775,950 | 169,341 | 945,291 |
| 2016 | 748,252 | 169,341 | 917,593 |
| 2017 | 804,104 | - | 804,104 |
| Thereafter | 2,314,656 | - | 2,314,656 |
| | $ 7,343,955 | $ 788,361 | $ 8,132,316 |

All payments to the Laboratory for work performed on contracts with agencies of the U.S. Government are provisional payments which are subject to adjustment upon audit by the Defense Contract Audit Agency (DCAA). Audits through fiscal year 2011 have been completed and rates have been finalized and recorded.

In 2007, the Laboratory established a liability for environmental cleanup costs associated with soil contamination at a test facility under the requirements of ASC 410-30, *Asset Retirement and Environmental Obligations – Environmental Obligations*. The Laboratory has compiled estimates of the cleanup costs under various scenarios and will update those estimates as conditions change in future periods. Due to the long-term nature of the remediation activities, the Laboratory has discounted the expected future expenditures to the current period, using a rate of 5.23%. At June 29, 2012 the Laboratory’s recorded liability was $3,895,419.

The Laboratory is subject to routine legal proceedings incidental to its business. While the ultimate liability from the proceedings is difficult to determine, in the opinion of management, the results of these proceedings will not have a material adverse effect on the Laboratory's financial position or results of operations.

## 6. Pension and Other Post-retirement Benefit Plans

The Laboratory has three defined benefit pension plans and one post-retirement benefit plan providing health care benefits to retired employees. The current period cost of administering these benefit plans is included within operating activities as an indirect cost. The remaining changes to the benefit obligations are recorded in other changes in pension and post retirement benefits as a part of non-operating activities in the statement of activities and change in net assets.

The following schedules provide summary information concerning the Laboratory's benefit plans for the years ended June 29, 2012 and July 1, 2011:

| | Pension Benefits | | Medical Benefits | |
|---|---|---|---|---|
| | **2012** | **2011** | **2012** | **2011** |
| **Benefit obligation at end of year** | $ 142,531,472 | $ 115,578,329 | $ 30,380,540 | $ 26,801,799 |
| **Fair value of plan assets at end of year** | 110,257,239 | 109,781,693 | 10,681,996 | 9,984,664 |
| Unfunded status of the plans | $ (32,274,233) | $ (5,796,636) | $ (19,698,544) | $ (16,817,135) |
| **Consolidated balance sheets** | | | | |
| Current liabilities | $ (1,082,000) | $ - | $ - | $ - |
| Noncurrent assets | 3,581,461 | 4,428,328 | - | - |
| Noncurrent liabilities | (34,773,694) | (10,224,964) | (19,698,544) | (16,817,135) |
| Unfunded status of the plans | $ (32,274,233) | $ (5,796,636) | $ (19,698,544) | $ (16,817,135) |
| **Net period benefit cost** | $ 1,850,562 | $ 2,024,163 | $ 1,719,287 | $ 1,787,810 |
| **Amounts not yet reflected in net periodic benefit cost and included in unrestricted net assets:** | | | | |
| Accumulated actuarial loss (gain) | $ 41,472,433 | $ 13,178,318 | $ 1,961,387 | $ (1,013,450) |
| Prior service costs (benefits) | 184,935 | 289,992 | (82,095) | (164,193) |
| Transition Obligation | 840,191 | 945,215 | - | - |
| | $ 42,497,559 | $ 14,413,525 | $ 1,879,292 | $ (1,177,643) |

The Retirement Plan for Employees (RPE) provides retirement benefits paid from the net assets available for plan benefits. Retirement benefits are paid to participants in equal monthly payments beginning in the month following retirement and continue until death. Payments to a surviving spouse are made at a reduced level. This plan comprises approximately 85% of the Laboratory's pension benefit obligations and plan assets.

The Retirement Plan for Staff Members (RPSM) provides a Surviving Spouse's Benefit, which provides a supplement for married participants who transferred to the Laboratory from the Massachusetts Institute of Technology prior to July 2, 1976, and a Minimum Pension Benefit, which provides a minimum level of retirement benefits based upon years of service and final average salary, through a group annuity; the plan was frozen during 2009. This plan, together with the Supplemental Retirement Plan for Corporate Officers and Retiree Medical Benefit Plan (RMP), comprises the remainder of the Laboratory's benefit obligations and plan assets.

The Retiree Medical Benefit Plan provides post-retirement Medicare supplemental health insurance and prescription drug benefits. The Laboratory's contributions to the plan are capped.

**Benefit Obligations**
The components of the change in total benefit obligation and the applicable assumptions for determining benefit obligations are shown below:

| | **Pension Benefits** | | **Medical Benefits** | |
|---|---|---|---|---|
| | **2012** | **2011** | **2012** | **2011** |
| Benefit obligation at beginning of year | $ 115,578,329 | $ 109,899,845 | $ 26,801,799 | $ 26,297,203 |
| Actuarial loss/(gain) | 657,000 | 1,829,156 | 528,218 | (6,746) |
| Service cost | 1,992,263 | 1,983,893 | 1,137,124 | 1,098,820 |
| Interest cost | 5,414,625 | 5,243,276 | 1,363,187 | 1,312,169 |
| Plan participants' contributions | - | - | 3,146,209 | 3,003,794 |
| Change in assumptions | 22,856,411 | 357,325 | 1,745,023 | (861,346) |
| Benefits paid | (3,967,156) | (3,735,166) | (4,341,020) | (4,042,095) |
| Benefit obligation at end of year | $ 142,531,472 | $ 115,578,329 | $ 30,380,540 | $ 26,801,799 |
| Accumulated benefit obligation | $ 140,706,092 | $ 113,274,917 | | |
| Weighted-average assumptions | | | | |
| Discount rate | 3.55% | 4.85% | 3.75% | 5.25% |
| Rate of compensation increase | 3.04% | 3.85% | n/a | n/a |

### Benefit Cost

The components of the net periodic benefit cost recognized in the statements of activities and changes in net assets, and the applicable assumptions for determining benefit costs, are shown below:

| | Pension Benefits | | Medical Benefits | |
|---|---|---|---|---|
| | **2012** | **2011** | **2012** | **2011** |
| Service cost | $ 1,992,263 | $ 1,983,893 | $ 1,137,124 | $ 1,098,820 |
| Interest cost | 5,414,625 | 5,243,276 | 1,363,187 | 1,312,169 |
| Expected return on plan assets | (6,651,140) | (6,538,679) | (698,926) | (541,081) |
| Amortization of prior service cost | 105,057 | 105,057 | (82,098) | (82,098) |
| Amortization of transition obligation | 105,024 | 105,024 | - | - |
| Amortization of net actuarial loss | 884,733 | 1,125,592 | - | - |
| Net periodic benefit cost | $ 1,850,562 | $ 2,024,163 | $ 1,719,287 | $ 1,787,810 |
| Changes in plan assets and benefit obligations recognized in unrestricted net assets | | | | |
| Net loss (gain) | $ 29,178,848 | $ (9,471,760) | $ 2,974,838 | $ (2,581,944) |
| Amortizations | (1,094,814) | (1,335,673) | 82,098 | 82,098 |
| Total recognized in unrestricted net assets | $ 28,084,034 | $ (10,807,433) | $ 3,056,936 | $ (2,499,846) |
| Total recognized in net periodic benefit cost and unrestricted net assets | $ 29,934,596 | $ (8,783,270) | $ 4,776,223 | $ (712,036) |
| Weighted-average assumptions | | | | |
| Discount rate | 4.92% | 4.89% | 5.25% | 5.15% |
| Expected long-term return on plan assets | 7.00% | 7.00% | 7.00% | 7.00% |
| Rate of compensation increase | 3.85% | 3.85% | n/a | n/a |

Amortizations of pension benefit prior service costs, transition obligations and actuarial gains and losses in 2013 are expected to be $105,057, $105,024, and $4,040,635, respectively. Amortization of medical benefit prior service costs in 2013 is expected to remain at the straight line amortization rate of $82,095.

**Assumptions**

The discount rate is determined annually based on census information, the timing of future benefit payments and yield curve data from the Mercer Yield Curve as of the valuation date for calculating net periodic benefit cost, and as of year-end for financial statement disclosure.

The expected long-term rate of return assumption represents the expected average rate of return on current and future funds invested to provide for benefit obligations. This assumption is determined based on a number of factors, including historical market index returns, historical plan return data, anticipated long-term asset allocation of the plans and plan expenses. The Laboratory recognizes differences between the expected return on assets and the actual return over the remaining service life of the applicable participants. This amount is included in net periodic pension cost as a component of the amortization of actuarial gains and losses and is expected to be $4,040,635 in 2013.

Assumed health care cost trend rates at June 29, 2012 and July 1, 2011 were as follows:

| | 2012 | 2011 |
|---|---|---|
| Health care cost trend rate for pre-65 coverage assumed for next year | 7.62% | 7.91% |
| Health care cost trend rate for post-65 coverage assumed for next year | 7.62% | 7.91% |
| Rate to which the cost trend rate is assumed to decline (the ultimate trend rate) | 4.50% | 4.50% |
| Year that the rate reaches the ultimate trend rate | 2027 | 2030 |

Assumed healthcare costs trend rates can have a significant effect on the amounts reported for health care plans. A one-percentage point change in the assumed health care cost trend rates would have the following effects at June 29, 2012 and July 1, 2011:

| | Medical Benefits | |
|---|---|---|
| | 2012 | 2011 |
| Impact of 1% increase in assumed health care cost trend rates | | |
| Effect on total of service and interest cost components | $ 146,905 | $ 140,935 |
| Effect on postretirement benefit obligation | 1,201,071 | 949,178 |
| Impact of 1% decrease in assumed health care cost trend rates | | |
| Effect on total of service and interest cost components | (125,599) | (120,804) |
| Effect on postretirement benefit obligation | (1,047,297) | (833,147) |

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 (providing Medicare Part D – Prescription Drug benefits) was reflected in the Laboratory's accounting results assuming that the Laboratory will continue to provide the same (capped) level of contributions for each participant of the post-retirement medical plan; however any federal subsidy received will be applied to reduce the retiree participants' share of the cost.

**Plan Assets**
The components of the change in total plan assets are shown below:

| | Pension Benefits | | Medical Benefits | |
|---|---|---|---|---|
| | **2012** | **2011** | **2012** | **2011** |
| Fair value of plan assets at beginning of year | $ 109,781,693 | $ 95,319,939 | $ 9,984,664 | $ 7,729,731 |
| Actual return on plan assets | 1,131,841 | 18,170,569 | (2,668) | 2,254,933 |
| Employer contributions | 3,457,000 | - | 1,894,811 | 1,038,301 |
| Plan participants' contributions | - | - | 3,146,209 | 3,003,794 |
| Benefits paid | (3,967,156) | (3,735,166) | (4,341,020) | (4,042,095) |
| Fair value adjustments | (146,139) | 26,351 | - | - |
| Fair value of plan assets at end of year | $ 110,257,239 | $ 109,781,693 | $ 10,681,996 | $ 9,984,664 |

The investment objectives for the assets of the plan are to meet or exceed current and future benefit payments while minimizing employer contributions. Investment policies and strategies governing the assets of the plans are designed to achieve investment objectives within the constraints of a prudent level of portfolio risk and diversification. Risk management practices include the use of investment managers and maintenance of a portfolio diversified by asset class, investment approach and securities holdings, and the maintenance of sufficient liquidity to meet benefit obligations as they come due.

The Laboratory's pension plans weighted-average asset allocations by asset category are as follows:

| | RPE | | | RPSM | | | Total Pension |
|---|---|---|---|---|---|---|---|
| | | Asset Allocation | | | Asset Allocation | | |
| | Fair Value | Range | Actual | Fair Value | Range | Actual | |
| **June 29, 2012** | | | | | | | |
| U.S. fixed income | $ 25,241,303 | 16-30% | 27% | $ - | - | - | $ 25,241,303 |
| Global equity funds | 42,509,955 | 45-60% | 46% | 8,569,146 | 40-60% | 50% | 51,079,101 |
| U.S. real estate fund | 5,998,281 | 5-10% | 6% | - | - | - | 5,998,281 |
| Insurance contracts | 19,333,963 | 15-30% | 21% | 8,604,591 | 40-60% | 50% | 27,938,554 |
| | $ 93,083,502 | | | $ 17,173,737 | | | $ 110,257,239 |
| **July 1, 2011** | | | | | | | |
| U.S. fixed income | $ 25,109,157 | 16-30% | 27% | $ - | - | - | $ 25,109,157 |
| Global equity funds | 47,211,843 | 45-60% | 52% | 8,928,125 | 40-60% | 50% | 56,139,968 |
| U.S. real estate fund | 4,831,683 | 5-10% | 5% | - | - | - | 4,831,683 |
| Insurance contracts | 14,944,561 | 15-30% | 16% | 8,756,324 | 40-60% | 50% | 23,700,885 |
| | $ 92,097,244 | | | $ 17,684,449 | | | $ 109,781,693 |

The disclosure provisions of ASC 820, *Fair Value Measurements and Disclosure*, were adopted as of fiscal year 2010 for benefit plan assets. The following tables present information about the assets that are measured at fair value on a recurring basis as of June 29, 2012, and indicate the fair value hierarchy of the valuation techniques we utilized to determine such fair value.

| | June 29, 2012 | Level 1 Assets | Level 2 Assets | Level 3 Assets |
|---|---|---|---|---|
| Investment securities | | | | |
| U.S. fixed income | $ 25,241,303 | $ - | $ 25,241,303 | $ - |
| Global equity fund | 51,079,101 | - | 51,079,101 | - |
| U.S. real estate fund | 5,998,281 | - | 5,998,281 | - |
| Insurance contracts | 27,938,554 | - | - | 27,938,554 |
| | $ 110,257,239 | $ - | $ 82,318,685 | $ 27,938,554 |

| | July 1, 2011 | Level 1 Assets | Level 2 Assets | Level 3 Assets |
|---|---|---|---|---|
| Investment securities | | | | |
| U.S. fixed income | $ 25,109,157 | $ - | $ 25,109,157 | $ - |
| Global equity fund | 56,139,968 | - | 56,139,968 | - |
| U.S. real estate fund | 4,831,683 | - | 4,831,683 | - |
| Insurance contracts | 23,700,885 | - | - | 23,700,885 |
| | $ 109,781,693 | $ - | $ 86,080,808 | $ 23,700,885 |

In general, fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets and liabilities. Fair values determined by Level 2 inputs utilize data points that are observable, such as quoted prices, interest rates and yield curves. The Laboratory's Level 2 assets consist of variable annuities, all of which are measured at the NAV provided by the investment company.

Fair values determined by Level 3 inputs utilize unobservable data points for the asset or liability, and include situations where there is little, if any, observable market activity for the asset or liability. The Laboratory's Level 3 assets as of June 29, 2012 consist of an insurance contract, the value of which was provided by the insurance company and reviewed for reasonableness by the Laboratory. There are no liquidity restrictions associated with any of the Laboratory's plan assets measured at fair value.

The change in the fair value of the Laboratory's benefit plan assets with unobservable data points is shown below:

**Fair Value Measurements Using Significant Unobservable Inputs (Level 3)**

| | Insurance Contracts |
|---|---|
| **June 29, 2012** | |
| Balance at beginning of year | $ 23,700,885 |
| Purchases | 7,252,762 |
| Total gains | 1,268,783 |
| Benefits paid | (4,283,876) |
| Balance at end of year | $ 27,938,554 |
| **July 1, 2011** | |
| Balance at beginning of year | $ 24,376,921 |
| Purchases | 2,000,000 |
| Total gains | 1,059,130 |
| Benefits paid | (3,735,166) |
| Balance at end of year | $ 23,700,885 |

The Laboratory's Retiree Medical Benefit Plan weighted-average asset allocations by asset categories are as follows:

| | | Asset Allocation | |
|---|---|---|---|
| | Fair Value | Range | Actual |
| **June 29, 2012** | | | |
| Investment-grade fixed income fund | $ 1,961,009 | 12-26% | 18% |
| High-yield bond fund | 707,128 | 3-11% | 7% |
| Domestic equity funds | 5,806,592 | 33-73% | 54% |
| International equity funds | 1,675,014 | 3-24% | 16% |
| Real estate securities fund | 532,253 | 5-11% | 5% |
| | $ 10,681,996 | | |
| **July 1, 2011** | | | |
| Investment-grade fixed income fund | $ 1,656,757 | 12-26% | 17% |
| High-yield bond fund | 658,376 | 3-11% | 6% |
| Domestic equity funds | 5,287,038 | 33-73% | 53% |
| International equity funds | 1,886,233 | 3-24% | 19% |
| Real estate securities fund | 496,260 | 5-11% | 5% |
| | $ 9,984,664 | | |

All of the Retiree Medical Benefit Plan assets are mutual funds traded in active markets for identical assets (Level 1 assets).

**Contributions and Benefits**

The Laboratory does not anticipate making any contributions to the RPSM in 2013. The Retiree Medical Plan was funded on a "pay as you go" basis in 2011 and 2012. However, the Laboratory anticipates contributing an additional $325,000 to the plan in 2013 to meet funding requirements calculated under U.S. Government Cost Accounting Standards.

The current macroeconomic environment, specifically low interest rates, combined with asset valuations utilized for determining pension funding requirements may result in contributions to the RPE in 2013. While the amount of any such contribution cannot yet be determined, management does not anticipate a material adverse effect on the Laboratory's financial position or results of operations.

Estimated future benefit payments, which reflect future service as appropriate, are as follows:

| | Pension Benefits | Medical Benefits |
|---|---|---|
| 2013 | $ 19,763,000 | $ 1,569,323 |
| 2014 | 6,328,000 | 1,616,263 |
| 2015 | 7,952,000 | 1,654,876 |
| 2016 | 6,175,000 | 1,699,291 |
| 2017 | 5,922,000 | 1,764,675 |
| Years 2018-2022 | 34,328,000 | 10,501,194 |

## 7. Deferred Charges and Other Assets

As permitted under CAS, overhead costs associated with the PeopleSoft software implementation projects are recorded as deferred charges and are being recovered over five years as charges to indirect contract costs. At June 29, 2012 and July 1, 2011, the balance of these costs was $381,252 and $17,179, respectively. In fiscal 2012, overhead costs of $469,234 associated with the Service Procurement Module implementation was recorded as deferred charges. In 2012, the Laboratory changed its accounting methodology for SRPCO expensing the balance of the deferred charges in year the benefit is paid, see Note 1. At June 29, 2012 and July 1, 2011, the balance of these costs was $0 and $2,770,564, respectively.

## 8. Line of Credit

In 2012 and 2011, the Laboratory did not make any withdrawals or payments under its short-term line of credit arrangements. Currently, the Laboratory has short term lines of credit with Bank of America and BNY Mellon. At June 29, 2012 and July 2, 2010, there were no balances outstanding under the credit facilities. The lines of credit may be renewed annually.

## 9. Bonds Payable

Effective October 23, 2008, the Laboratory issued $80,000,000, net of a discount of $970,946, of Massachusetts Development Finance Agency (MDFA) Fixed Rate Demand Revenue Bonds, Draper Laboratory Issue, Series 2008 (the "Series 2008 Bonds"); the Series 2008 Bonds are uncollateralized. The proceeds of the Series 2008 Bonds were used to extinguish the outstanding Series 2000 Bonds as well as provide funding for additional facility and computer upgrades as needed.

The Series 2008 Bonds have no restrictive covenants of a financial nature. The estimated fair value of the Series 2008 Bonds was $91,645,648 and $87,279,701 at June 29, 2012 and July 1, 2011, respectively.

The Series 2008 Bonds have been issued in four groups with varying maturity dates and interest rates, as follows:

| Maturity Date | Interest Rate | Maturity Amount |
|---|---|---|
| September, 2015 | 4.75% | $ 22,500,000 |
| September, 2020 | 5.50% | 10,000,000 |
| September, 2025 | 5.75% | 25,865,000 |
| September, 2030 | 5.88% | 21,635,000 |
| | | $ 80,000,000 |

The following is a summary of the Laboratory's bonds payable at June 29, 2012 and July 1, 2011:

| | 2012 | 2011 |
|---|---|---|
| Outstanding bonds | $ 80,000,000 | $ 80,000,000 |
| Less: bond discount | (817,076) | (871,209) |
| Total bonds payable | $ 79,182,924 | $ 79,128,791 |

## 10. Asset Retirement Obligations

During 2012 and 2011, the Laboratory recognized the following changes to the fair value of its conditional asset retirement obligations:

| | 2012 | 2011 |
|---|---|---|
| Fair value of liability at beginning of year | $ 6,018,308 | $ 5,677,850 |
| Liabilities settled | (186,908) | (14,408) |
| Accretion of fair value | 376,144 | 354,866 |
| Fair value of liability at end of year | $ 6,207,544 | $ 6,018,308 |

## 11. Deferred Revenue

The Laboratory entered into an agreement with the Office of Tourism, Trade and Economic Development in the State of Florida on June 30, 2008. The total value of this agreement is approximately $15,000,000 substantially all of which has been received by the close of 2012. The Laboratory also secured an additional $15,000,000 in matching awards from various other parties described below. These matching awards will be received in the form of equipment, donated facilities, and rent incentives over the next ten years. These agreements include several provisions that require the initial deferral of revenue as described below.

In 2012 and 2011, the Laboratory received $1,000,000 and $3,000,000 respectively, from the State of Florida under this arrangement. The terms of the award stipulate that the Laboratory needs to create a specified number of salaried positions, generate a specified level of proposals, and incur costs related to equipment purchases at specified milestone dates during the contract period. Provided that the Laboratory has met the related conditions of the award, revenue will be recognized in proportion to costs incurred under the agreement. If the Laboratory fails to meet its stipulated terms at the milestone dates, there may be a risk that future funding under the agreement could be forfeited. At June 29, 2012, the Laboratory was in compliance with its most recent milestones. The next milestone date is September 30, 2012. Accordingly, under this agreement the Laboratory has recorded revenue of $2,310,980 and $3,495,273 in each of the years ended June 29, 2012 and July 1, 2011 respectively, under this agreement and has deferred approximately $0 and $1,310,980 as of June 29, 2012 and July 1, 2011, respectively, to be recognized as costs are incurred in future periods.

Pursuant to the terms of an agreement with the Laboratory, Pinellas County, Florida, provided $2,000,000 to the Laboratory to be used for the purchase of equipment. These funds have been recorded in deferred revenue as of June 26, 2009 and are being amortized into revenue over the equipment's useful life of five years since it was placed into service beginning in 2010. Accordingly, the Laboratory has recorded $400,000 of revenue under this agreement in each of the years ending June 29, 2012 and July 1, 2011.

Pursuant to the terms of an agreement with the Laboratory, Hillsborough County, Florida, provided $685,025 and $612,224 of equipment to the Laboratory in 2012 and 2011, respectively. These funds have been recorded in deferred revenue as of June 29, 2012 and July 1, 2011, respectively and are being recognized as revenue over the equipment's useful life of five years. Accordingly, the Laboratory has recorded $317,913 and $176,712 of revenue under this agreement during 2012 and 2011, respectively.

Pursuant to the terms of an agreement with the Laboratory, Hillsborough County, Florida, provided $161,899 for purchase of leasehold improvements to be capitalized by the Laboratory. These funds have been recorded in deferred revenue as of July 1, 2011 and are being recognized as revenue over the useful life of the leasehold improvements; in 2012 the Laboratory has recorded $24,052 of revenue.

Pursuant to the terms of an agreement with the Laboratory, Florida High Tech Corridor Council provided $985,873 of equipment to the Laboratory. These funds have been recorded in deferred revenue as of July 2, 2010 and are being amortized into revenue over the equipment's useful life of five years since it was placed into service beginning in 2010. Accordingly, the Laboratory has recorded $197,175 and $195,910 of revenue under this agreement during 2012 and 2011, respectively.

In accordance with the Laboratory's lease with the USF Research Foundation (the Landlord), the Landlord provided $2,000,000 to the Laboratory to be used for the purchase of leasehold improvements to be capitalized by the Laboratory. These funds have been recorded as deferred revenue at June 26, 2009 and in 2012 the Laboratory has recorded $110,079 as an offset to depreciation.

In addition, the Laboratory entered into a contract with Hillsborough County, Florida, wherein the County has agreed to fund $976,000 of rent obligations pursuant to a ten year lease with the University of South Florida. The rent subsidies are stipulated to fund the rent obligations due in years 4 and 5 of the rental agreement (see Note 3). This pledge for future benefits has been classified as deferred charges on the balance sheets and will be recognized into revenue during years 4 and 5 of the lease. In fiscal year 2012, year 4 of the lease the Laboratory recognized $240,400 of this deferred charge.

## 12. Results of Operations

Total operating revenue is $514,059,482 in 2012 and $528,102,064 in 2011. The majority of our revenue is with the U.S. Government and related agencies.

Direct expenses are $379,947,682 in 2012 compared to $408,079,543 in 2011.

Indirect costs are $130,771,728 in 2012 and $126,648,852 in 2011. The increase is due primarily to employee related costs. These costs include merit increases and employee benefit costs.

## 13. Subsequent Events

The Laboratory has performed an evaluation of subsequent events through September 25, 2012, which is the date the consolidated financial statements were available to be issued.

# The Charles Stark Draper Laboratory, Inc.
## Schedule of Expenditures of State Financial Assistance
## June 29, 2012

| State Agency | CSFA Numbers | Contract Number | Direct | Total 2012 Expenditures |
|---|---|---|---|---|
| State of Florida Executive Office of the Governor | 31.054 | OT08-166 | $ 2,424,743 | $ 2,424,743 |
| **Total Expenditures of State Financial Assistance** | | | $ 2,424,743 | $ 2,424,743 |

The accompanying notes are an integral part of the Schedule of Expenditures of State Financial Assistance.

## 1. Basis of Presentation

The accompanying Schedule of Expenditures of State Financial Assistance (the "Schedule") has been prepared in accordance with the requirements of *Florida Single Audit Act,* Audits Nonprofits and For-Profits Organizations, Chapter 10.650, Rules of the Auditor General using the accrual basis of accounting. The purpose of the Schedule is to present a summary of The Charles Stark Draper Laboratory, Inc.'s (the "Laboratory") research program for the year ended June 29, 2012, which has been funded by the State of Florida ("State Awards"). For purposes of the Schedule, state awards include all state contracts entered into directly between the Laboratory and the State of Florida. Because the Schedule presents only the state award activity of the Laboratory, the Schedule is not intended to, and does not, present either the financial position or changes in net assets of the Laboratory.

## 2. Description of the Award

The Laboratory entered into an agreement with the Office of Tourism, Trade and Economic Development on June 30, 2008. The Office of Tourism, Trade and Economic Development is administered within the Executive Office of the Governor. The total value of this agreement is approximately $15,000,000 substantially all of which has been received by the close of fiscal year 2012. The terms of the award stipulate that the Laboratory needs to create a specified number of salaried positions, generate a specified level of proposals, and incur costs related to equipment purchases during the contract period. In addition, the Laboratory procured an additional $15,000,000 in matching awards from various other parties. These matching awards have been and continue to be received in the form of equipment, donated facilities, and rent incentives over the next ten years.

**Report of Independent Auditors on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with *Government Auditing Standards***

To the Board of Directors of
The Charles Stark Draper Laboratory, Inc.:

We have audited the consolidated financial statements of The Charles Stark Draper Laboratory, Inc. and its subsidiaries (the "Laboratory") as of and for the year ended June 29, 2012, and have issued our report thereon dated September 25, 2012. 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.

**Internal Control over Financial Reporting**
In planning and performing our audit, we considered the Laboratory's internal control over financial reporting as a basis for designing our auditing procedures 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 Laboratory's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Laboratory's internal control over financial reporting.

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

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

**Compliance and Other Matters**
As part of obtaining reasonable assurance about whether the Laboratory's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

*PricewaterhouseCoopers LLP, 125 High Street, Boston, MA 02110*
*T: (617) 530 5000, F: (617) 530 5001,* www.pwc.com/us

We noted certain matters that we reported to management of the Laboratory in a separate letter dated October 2, 2012.

This report is intended solely for the information and use of the Laboratory's Board of Directors, management, and state awarding agencies and is not intended to be and should not be used by anyone other than those specified parties.

PricewaterhouseCoopers LLP

September 25, 2012

**Report of Independent Auditors on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major State Program and on Internal Control over Compliance in Accordance with Chapter 10.650 of the Rules of the Auditor General, State of Florida**

To the Board of Directors of
The Charles Stark Draper Laboratory, Inc.:

**Compliance**

We have audited the Laboratory's compliance with respect to the compliance requirements of eligibility and matching as described in the Rules of the Auditor General, State of Florida Matrix of Compliance Requirements that could have a direct and material effect on its major state program for the year ended June 29, 2012. The Laboratory's major state program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirement of laws, regulations, contracts and grants applicable to each of its major state program is the responsibility of the Laboratory's management. Our responsibility is to express an opinion on the Laboratory's compliance based on our audit.

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 Chapter 10.650 of the Rules of the Auditor General, State of Florida. Those standards and the Chapter 10.650 of the Rules of the Auditor General, State of Florida 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 state program occurred. An audit includes examining, on a test basis, evidence about the Laboratory'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. Our audit does not provide a legal determination of the Laboratory's compliance with those requirements.

In our opinion, the Laboratory complied, in all material respects, with the compliance requirements applicable to its major state program for the year ended June 29, 2012.

**Internal Control over Compliance**

Management of the Laboratory is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to state programs. In planning and performing our audit, we considered the Laboratory's internal control over compliance with the requirements that could have a direct and material effect on a major state program in order to determine our auditing procedures with respect to the matching and eligibility requirements for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with Chapter 10.650 of the Rules of the Audit General State of Florida, 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 Laboratory's internal control over compliance.

A deficiency in an entity's internal control over compliance 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 noncompliance with a type of compliance requirement of a state 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 state program will not be prevented or detected and correct on a timely basis.

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 deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of the Laboratory's Board of Directors, management, and state awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

PricewaterhouseCoopers LLP

April 26, 2013

# The Charles Stark Draper Laboratory, Inc.
## Schedule of Findings and Questioned Costs
## June 29, 2012

**I. Summary of Results**

**Financial Statements**

| | | |
|---|---|---|
| Type of auditor's report issued | Unqualified | |
| Internal control over financial reporting | | |
| • Material weakness(es) identified? | ___ yes | _√_ no |
| • Significant deficiency(ies) identified that are not considered to be material weaknesses? | ___ yes | _√_ none reported |
| Noncompliance material to the financial statements noted? | ___ yes | _√_ no |

**State Awards**

| | | |
|---|---|---|
| Internal control over major programs | | |
| • Material weakness(es) identified? | ___ yes | _√_ no |
| • Significant deficiency(ies) identified that are not considered to be material weaknesses? | ___ yes | _√_ none reported |
| Type of auditor's report issued on compliance for major programs | Unqualified | |
| Any audit findings disclosed that are required to be reported in accordance with Chapter 10.650 of the Rules of the Auditor General, State of Florida | ___ Yes | _√_ no |

**Identification of Major State Program**

| CSFA Number | Name of State of Florida Program |
|---|---|
| 31.054 | Innovation Incentive Program |

### II. Financial Statement Findings

None noted. In addition, there are no management letter items related to State Financial Assistance.

### III. State Award Findings and Questioned Costs

None noted.

### IV. Prior Year State Award Findings and Questioned Costs

None noted.