

FLORIDA INSTITUTE FOR HUMAN AND MACHINE COGNITION, INC.

PENSACOLA, FLORIDA

FINANCIAL STATEMENTS

JUNE 30, 2008 AND 2007

FLORIDA INSTITUTE FOR HUMAN AND MACHINE COGNITION, INC.

PENSACOLA, FLORIDA

FINANCIAL STATEMENTS

JUNE 30, 2008 AND 2007

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Florida Institute for Human and Machine Cognition, Inc.
Pensacola, Florida

We have audited the accompanying statements of financial position of Florida Institute for Human and Machine Cognition, Inc. (IHMC) (a nonprofit organization) as of June 30, 2008 and 2007, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of IHMC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of IHMC as of June 30, 2008 and 2007, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated **October XX, 2008**, on our consideration of IHMC'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 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 audits.

Board of Directors
Florida Institute for Human and Machine Cognition, Inc.

Our audits were performed for the purpose of forming an opinion on the basic financial statements of IHMC taken as a whole. The accompanying Schedules of General and Administrative Expenses are presented for purposes of additional analysis and are not a required part of the basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

Pensacola, Florida
October XX, 2008

FLORIDA INSTITUTE FOR HUMAN AND MACHINE COGNITION, INC.
STATEMENTS OF FINANCIAL POSITION
JUNE 30, 2008 AND 2007

ASSETS

	2008	2007
Cash	\$ 2,221,968	\$ 2,447,490
Grants, contracts, and accounts receivable	2,059,400	1,518,060
Pledges receivable	154,094	72,496
Prepaid expenses	43,416	47,337
Property and equipment, net	6,183,381	4,585,671
Financing costs and other assets, net	128,197	6,291
Total Assets	\$ 10,790,456	\$ 8,677,345

LIABILITIES AND NET ASSETS

Liabilities:		
Accounts payable	\$ 205,647	\$ 286,206
Accrued payroll and related liabilities	330,120	293,062
Refundable advances	368,811	-
Note payable	4,284,658	4,200,000
Total liabilities	5,189,236	4,779,268
Commitments and Contingencies	--	--
Net Assets:		
Unrestricted	5,451,838	3,825,581
Temporarily restricted	149,382	72,496
Total net assets	5,601,220	3,898,077
Total Liabilities and Net Assets	\$ 10,790,456	\$ 8,677,345

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

FLORIDA INSTITUTE FOR HUMAN AND MACHINE COGNITION, INC.
STATEMENTS OF ACTIVITIES
YEARS ENDED JUNE 30, 2008 AND 2007

	2008	2007
Change in Unrestricted Net Assets:		
Support, Revenue and Reclassifications:		
Research and development grants and contracts -		
Federal and pass-through grants	\$ 6,529,852	\$ 5,556,503
Other grants and contracts	2,596,652	2,990,875
Legislative appropriation	2,873,636	2,606,848
Contributions	766,183	11,700
Contributed facilities and administrative allocation	122,239	139,545
In-kind donations	6,472	3,227
Other revenue	82,414	95,721
Net assets released from restrictions	11,283	-
	<u>12,988,731</u>	<u>11,404,419</u>
Expenses:		
Program services -		
Research and development grants and contracts	8,739,160	7,936,901
Other program services	30,210	19,256
Total program services	<u>8,769,370</u>	<u>7,956,157</u>
Supporting services -		
Fundraising services -		
Salaries and employee benefits	146,533	129,920
Other fundraising expenses	11,475	11,522
General and administrative	158,008	141,442
Total supporting services	<u>2,435,096</u>	<u>1,399,127</u>
Total expenses	<u>11,362,474</u>	<u>9,496,726</u>
Excess of support and revenue over expenses	1,626,257	1,907,693
Other:		
Hurricane recovery -		
Insurance proceeds	-	58,279
Change in unrestricted net assets	<u>1,626,257</u>	<u>1,965,972</u>

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

FLORIDA INSTITUTE FOR HUMAN AND MACHINE COGNITION, INC.
STATEMENTS OF ACTIVITIES
YEARS ENDED JUNE 30, 2008 AND 2007
(Continued)

	2008	2007
Change in Temporarily Restricted Net Assets:		
Contributions	88,169	72,496
Net assets released from restrictions	(11,283)	-
Change in temporarily restricted net assets	76,886	72,496
Change in Net Assets	1,703,143	2,038,468
Net Assets, Beginning of Year	3,898,077	1,859,609
Net Assets, End of Year	<u>\$ 5,601,220</u>	<u>\$ 3,898,077</u>

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

FLORIDA INSTITUTE FOR HUMAN AND MACHINE COGNITION, INC.
STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2008 AND 2007

	2008	2007
Cash Flows From Operating Activities:		
Change in net assets	\$ 1,703,143	\$ 2,038,468
Adjustments to reconcile change in net assets to net cash provided by operating activities -		
Depreciation and amortization	255,637	145,796
Donated equipment	(700,000)	
Changes in operating assets and liabilities -		
Grants, contracts, and accounts receivable	(541,340)	(366,078)
Pledges receivable	(81,598)	(72,496)
Prepaid expenses	3,921	(15,477)
Accounts payable	(80,559)	197,831
Accrued payroll and related liabilities	37,058	31,674
Refundable advance	368,811	(73,442)
Net cash provided by operating activities	<u>965,072</u>	<u>1,886,276</u>
Cash Flows From Investing Activities:		
Purchases of property and equipment	(1,151,877)	(401,500)
Net cash used in investing activities	<u>(1,151,877)</u>	<u>(401,500)</u>
Cash Flows From Financing Activities:		
Proceeds from note payable	15,534	-
Principal payments of note payable	(7,842)	-
Expenditures for financing costs	(46,409)	-
Net cash used in financing activities	<u>(38,717)</u>	<u>-</u>
Net Increase (Decrease) in Cash	(225,522)	1,484,776
Cash at Beginning of Year	<u>2,447,490</u>	<u>962,714</u>
Cash at End of Year	<u><u>\$ 2,221,968</u></u>	<u><u>\$ 2,447,490</u></u>
Supplemental Disclosure of Cash Flow Information:		
Interest paid	<u>\$ 206,381</u>	<u>\$ 210,000</u>
Noncash financing transaction -		
Note payable issued for refinance of purchase of property	<u>\$ 4,292,500</u>	<u>\$ -</u>
Noncash investing activity transaction -		
Contribution of equipment	<u>\$ 700,000</u>	<u>\$ -</u>

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



NOTES TO FINANCIAL STATEMENTS

FLORIDA INSTITUTE FOR HUMAN AND MACHINE COGNITION, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Purpose:

Florida Institute for Human and Machine Cognition, Inc. (IHMC) was organized as a Florida not-for-profit corporation on February 25, 2004, pursuant to Section 1004.447, Florida Statutes, exclusively as an information-technology related organization for research, education, scientific advancement, and economic development.

Basis of Accounting:

IHMC follows standards of accounting and financial reporting prescribed for not-for-profit organizations. It uses the accrual basis of accounting, which recognizes revenue when earned and expenses as incurred.

Basis of Presentation:

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

Permanently restricted net assets are subject to donor-imposed stipulations that the assets be maintained permanently, but permit IHMC to use or expend part or all of the income derived from the donated assets for either specified or unspecified purposes. IHMC had no permanently restricted net assets at June 30, 2008 and 2007.

Temporarily restricted net assets are subject to donor-imposed stipulations that can be fulfilled by actions of IHMC pursuant to those stipulations or that expire by the passage of time.

Unrestricted net assets are not subject to donor-imposed stipulations, or the donor-imposed restrictions have expired. Unrestricted net assets may be designated for specific purposes by the action of the Board of Directors, or may otherwise be limited by contractual agreements with outside parties.

Use of Estimates:

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

FLORIDA INSTITUTE FOR HUMAN AND MACHINE COGNITION, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Legislative appropriation:

Support from legislative appropriation represents amounts received from the state legislation budget, general revenue fund.

Contributions:

Contributions are reported as temporarily restricted if the donor limits the use of the donated assets. When the restrictions expire, these temporarily restricted net assets are reclassified to unrestricted net assets and are reported in the statement of activities as *net assets released from restrictions*. Donor-restricted contributions are classified as unrestricted revenues if the restrictions are met in the same reporting period in which the contributions are received.

Unconditional promises to give are reported when the pledges are received at the present value of their net realizable value. Conditional promises to give are not recorded in the financial statements.

Noncash contributions are recorded at fair market value at the time of donation. During 2008, IHMC accepted a noncash donation of equipment with a value of approximately \$700,000.

In-Kind Contributions:

Support arising from contributed occupancy and donated services are recognized as contributions in accordance with SFAS No. 116, *Accounting for Contributions Received and Contributions Made*. Donated services are recognized if the services (a) create or enhance nonfinancial assets or (b) require specialized skills, are performed by people with those skills, and would otherwise be purchased by IHMC. The computation of value for the contributions is based on the fair value of the contributed occupancy and donated services at the date received. These in-kind contributions are reported as support and expense in the period received.

Grants and Contracts:

Revenue from grants and contracts, awarded to and accepted by IHMC, is recognized as earned, that is, as the related allowable costs are incurred or the performance of milestones is achieved under the grant or contract agreements.

Facilities and administrative costs recovered on grants and contracts are recorded at rates established by IHMC with its Federal cognizant agency, or predetermined by the non-Federal sponsor. Facilities and administrative cost rates for government grants and contracts are subject to audit, and subsequent final settlements, if any, are recorded as current period adjustments. Management believes the impact of any future settlements to be immaterial to the financial statements.

FLORIDA INSTITUTE FOR HUMAN AND MACHINE COGNITION, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Financing costs:

Financing costs, including legal and other expenses associated with the issuance of IHMC's debt, have been capitalized and are being amortized on a straight-line basis over the terms of the related debt. Accumulated amortization was \$1,470 at June 30, 2008.

Property and Equipment:

Property and equipment are recorded at cost or at their estimated fair value at date of donation. Depreciation is provided using the straight-line method over the estimated useful lives of the assets as follows:

Building	30 years
Computers and software	3-5 years
Machinery and equipment	5-10 years
Vehicle	5 years

Additions and betterments of \$5,000 or more are capitalized, while maintenance and repairs that do not improve or extend the useful lives of the respective assets are expensed currently.

Refundable Advance:

Refundable advance represents funds received by IHMC, from grantor agencies that have not been spent at the end of the year. Advances must be returned to the grantor agency if not spent for their intended purpose within the grant period unless re-appropriated or extended by the grantor.

Advertising Costs:

Advertising costs are expensed when incurred.

Income Taxes:

IHMC is a nonprofit organization exempt from federal income taxes under Internal Revenue Code Section 501(c)(3) and has been classified by the Internal Revenue Service as a public charity. Accordingly, no provision for income taxes has been provided in the accompanying financial statements.

Reclassifications:

Certain amounts in the 2007 financial statements have been reclassified to conform to the 2008 presentation.

FLORIDA INSTITUTE FOR HUMAN AND MACHINE COGNITION, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

NOTE 2 - GRANTS, CONTRACTS AND ACCOUNTS RECEIVABLE

At June 30, 2008 and 2007, amounts due from grantor and other contracting agencies were as follows:

	2008	2007
Research and development grants and contracts -		
Federal and pass-through grants	\$ 1,333,445	\$ 1,139,313
Other grants and contracts	722,740	365,943
Other receivables	3,215	12,804
	<u>\$ 2,059,400</u>	<u>\$ 1,518,060</u>

Management considers all grants, contracts and accounts receivable at June 30, 2008 and 2007 to be fully collectible; therefore, no allowance for uncollectible accounts has been established.

The facilities and administrative allocation from the University represents the indirect overhead earned on grants administered through the University. Pursuant to an affiliation agreement entered into with the University, it is required to remit such earnings accruing to IHMC on a monthly basis.

NOTE 3 - PLEDGES RECEIVABLE

Unconditional promises to give at June 30, 2008 and 2007 are due as follows:

	2008	2007
In one year or less	\$ 48,730	\$ 11,000
Between one and five years	123,435	69,000
Total pledges receivable	172,165	80,000
Less discounts to net present value	18,071	7,504
Net pledges receivable	<u>\$ 154,094</u>	<u>\$ 72,496</u>

The discount rates used to calculate net present value range from 4-5%.

Management considers all pledges receivable at June 30, 2008 and 2007 to be fully collectible; therefore, no allowance for uncollectible pledges has been established.

FLORIDA INSTITUTE FOR HUMAN AND MACHINE COGNITION, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

NOTE 4 - PROPERTY AND EQUIPMENT

Property and equipment is comprised of the following:

	2008	2007
Land	\$ 1,142,640	\$ 1,071,400
Buildings	3,923,945	3,282,782
Computers and software	584,677	239,521
Machinery and equipment	759,065	59,065
Vehicle	24,130	24,130
Art collection	3,750	-
Construction in progress - prototype	286,921	196,353
	<u>6,725,128</u>	<u>4,873,251</u>
Less accumulated depreciation and amortization	<u>541,747</u>	<u>287,580</u>
	<u>\$ 6,183,381</u>	<u>\$ 4,585,671</u>

Depreciation and amortization expense for the years ended June 30, 2008 and 2007 was \$255,637 and \$145,796, respectively.

Certain fixed assets of IHMC were purchased with federal, state and local grants and contracts. As a result, if such assets are disposed, the granting agency that participated in the funding of the purchase has a contractual right to participate in the proceeds from the disposition. Also, at the end of the project for which the asset was purchased, the granting agency has the right to reclaim such equipment. IHMC accounts for these items separately until final release of the item has been received by IHMC.

NOTE 5 - NOTE PAYABLE

In May 2008, the Pensacola-Escambia County Promotion and Development Commission ("the Commission") issued \$4,292,500 industrial revenue bonds to provide financial assistance to IHMC for the refinance of debt with the University of West Florida Foundation, Inc. The bonds are payable solely from payments received from the underlying financing agreement with a term of 7 years, bearing interest at a rate of 4.43%, and secured by the property financed. Upon repayment of the bonds, ownership of the facilities transfers to IHMC. Pursuant to the financing and leasing agreements, IHMC has agreed to make rental payments to the Commission sufficient to pay all principal and interest amounts. IHMC executed and delivered a promissory note to the Commission, who has assigned to a Lender all rights to receive payments from IHMC related to these agreements. The Commission has no obligation in any manner for repayment of the bonds.

FLORIDA INSTITUTE FOR HUMAN AND MACHINE COGNITION, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

NOTE 5 - NOTE PAYABLE (Continued)

Maturities of the note payable are as follows:

Year ending June 30,

2009	\$ 96,398
2010	100,756
2011	105,311
2012	110,073
2013	115,049
Thereafter	<u>3,757,071</u>
Total	<u>\$ 4,284,658</u>

NOTE 6 - NET ASSETS

Temporarily restricted net assets at June 30, 2008 and 2007 consist of unconditional promises to give with payments due in future periods to be use for the activities of IHMC. These contributions are restricted until the lapse of time when the promises become due.

NOTE 7 - RETIREMENT PLAN

IHMC established a defined contribution retirement plan that operates under Section 403(b) of the Internal Revenue Code on March 1, 2005. The purpose of the plan is to provide retirement benefits for participating employees. Benefits are provided through Teachers Insurance and Annuity Association (TIAA), College Retirement Equities Fund (CREF). The plan year begins on July 1 and ends on June 30. All benefits under the Plan are fully funded and provided through the funding vehicle(s) selected by the participant. Benefits are not subject to, nor covered by, federal plan termination insurance.

The plan covers substantially all employees except part-time and leased. IHMC contributes 11% of eligible employee's compensation on a bi-weekly basis. Contributions to the plan amounted to \$564,062 in 2008 and \$466,888 in 2007.

In addition to the defined contribution plan, IHMC also established an elective deferral plan with the TIAA CREF. To participate, an eligible employee must enter into a written salary reduction agreement with IHMC. Under the salary reduction agreement, the employee's salary (paid after the agreement is signed) is reduced and the amount of the reduction is applied as premiums to the funding vehicles available under this plan.

FLORIDA INSTITUTE FOR HUMAN AND MACHINE COGNITION, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

NOTE 8 - RELATED PARTY TRANSACTIONS

University of West Florida:

Prior to the creation of IHMC as a separate nonprofit entity, the Institute for Human and Machine Cognition (UWF IHMC) performed information-technology research as a research division of the University. To assist in the transition of UWF IHMC activities to IHMC, the University and IHMC have entered into an affiliation agreement (the agreement) that addresses IHMC's use of or participation in University programs and services, including monies, personnel or services, and the use of facilities.

The University holds various accounts that have been earmarked for UWF IHMC. Pursuant to Section 1004.447(6)(a), Florida Statutes, IHMC has continued access to and use of these amounts. At June 30, 2008 and 2007, the University held \$11,987 and \$22,829, respectively, earmarked for UWF IHMC.

Also as stated in the affiliation agreement, IHMC is entitled to facilities and administrative allocations from the University which represents the indirect overhead earned on grants administered through the University. The contributed facilities and administrative allocations totaled \$122,239 and \$139,545 for the years ended June 30, 2008 and 2007, respectively.

The University provided in-kind support to IHMC by allowing University employees to offer services to IHMC while continuing to be employed through the University and retaining current level of University benefits. The value of the donated services and expenses included as contributions in the financial statements for the years ended June 30, 2008 and 2007, are as follows:

	2008	2007
General and administrative salaries	\$ 4,226	\$ 3,227
Operating expenses	2,246	-
	<u>\$ 6,472</u>	<u>\$ 3,227</u>

University of West Florida Foundation, Inc.:

On June 30, 2005, IHMC purchased a building and surrounding lots located at 40 South Alcaniz Street in downtown Pensacola from the University of West Florida Foundation, Inc. (the Foundation). IHMC executed a promissory note to the Foundation in the amount of \$4,200,000. For the years ended June 30, 2008 and 2007, IHMC paid interest to the Foundation in the amount of \$206,381 and \$210,000 respectfully, as required by the promissory note. As discussed in Note 5, the note payable to the Foundation was refinanced in May 2008.

FLORIDA INSTITUTE FOR HUMAN AND MACHINE COGNITION, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

NOTE 8 - RELATED PARTY TRANSACTIONS (Continued)

Board members:

One member of IHMC's Board of Directors is employed by Florida Atlantic University, another is employed at the University of Central Florida, and two members are either employed by or serve on the Board of Trustees for the University, all of which provide funding to IHMC. These individuals are asked to abstain from voting on items before the Board of Directors that will be funded by their respective agencies.

NOTE 9 - COMMITMENTS AND CONTINGENCIES

Lease commitments:

IHMC occupies two leased office spaces. One lease is for property located at 127 South Alcaniz Street and is dedicated to IHMC's administrative function. This lease expires in September 2011. The other property is located at 100 South Alcaniz and is dedicated to the robot prototype research. This lease expires in November 2011.

Future minimum lease payments under these facility leases are as follows:

Years Ending

June 30

2009

\$ 88,756

2010

92,707

2011

95,107

2012

31,398

\$ 307,968

Contingencies:

Grants and contracts require the fulfillment of certain conditions as set forth in the applicable agreements. Failure to fulfill the conditions could result in the return of funds to the grantors or contracting agencies. Although that is a possibility, IHMC deems the contingency remote, since by acceptance of the grants and contracts and their terms, it has structured the objectives of IHMC to meet the provisions of the agreements.

FLORIDA INSTITUTE FOR HUMAN AND MACHINE COGNITION, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

NOTE 9 - COMMITMENTS AND CONTINGENCIES (Continued)

Concentration of credit risk - uninsured cash balances:

IHMC maintains cash balances with three banks. Demand deposit accounts at the banks are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$100,000. Although balances may periodically exceed the FDIC insurance limit, management monitors the soundness of each financial institution and feels IHMC's risk is negligible. At June 30, 2008, IHMC's uninsured cash balances totaled approximately \$2,115,000.

Concentration of contract and grant receivables:

Approximately 39% of IHMC's contract and grant receivables and approximately 41% of contract and grant revenue is provided through agreements with the Office of Naval Research.

NOTE 10 - SUBSEQUENT EVENT

Federal Deposit Insurance Corporation coverage:

As noted above, IHMC maintains cash balances at several financial institutions in Florida, and accounts at each institution are insured by the Federal Deposit Insurance Corporation (FDIC). In October 2008, legislation was enacted that temporarily increased the maximum insured amount of balances at each institution from \$100,000 to \$250,000 through December 31, 2009.

SUPPLEMENTARY INFORMATION

OTHER REPORTS AND SCHEDULES

FLORIDA INSTITUTE FOR HUMAN AND MACHINE COGNITION, INC.
SCHEDULES OF GENERAL AND ADMINISTRATIVE EXPENSES
YEARS ENDED JUNE 30, 2008 AND 2007

	2008	2007
Salaries, including in-kind services	\$ 2,327,675	\$ 1,670,654
Payroll taxes	168,032	118,711
Employee benefit programs	321,495	232,198
Administrative travel	182,845	128,329
Meals and entertainment	22,767	21,960
Insurance	67,466	58,563
Legal and professional	552,049	428,033
Occupancy, including in-kind	259,363	211,131
Interest expense	206,381	210,000
Repairs and maintenance	89,567	44,541
Office expenses	95,961	134,213
Supplies	32,314	76,605
Telephone	92,539	119,883
Advertising expense	15,711	25,442
Lobbying costs	157,560	138,110
Licenses and fees	9,247	10,158
Memberships and continuing education	23,460	28,460
Community relations	2,199	6,459
Employee morale and welfare	15,874	13,347
Other	30,522	21,402
Depreciation and amortization	255,637	145,796
Indirect applied overhead, payroll taxes and employee benefits	(2,493,568)	(2,444,868)
Total General and Administrative Expenses	\$ 2,435,096	\$ 1,399,127

FLORIDA INSTITUTE FOR HUMAN AND MACHINE COGNITION, INC.
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2008

Federal Grantor, Pass-through Grantor, Program or Cluster Title	CFDA Number	Pass-through Agency's Identifying Number	Federal Expenditures
<u>Research and Development Cluster:</u>			
<u>Office of Naval Research</u>			
Sensory Substitution for Wounded Servicemembers	12.300	N00014-07-1-0790	\$ 2,804,145
Coordinated Operations of Humans, Agents, and Unmanned Vehicles for Littoral Warfare	12.300	N00014-06-1-0775	370,998
Rapidly Customizable Spoken Dialogue Language	12.300	N00014-05-1-0314	130,312
Deep Spatial Processing of Natural Language	12.630	HM1582-07-1-2038	114,228
Evidence Based Paraconsistency	12.630	HM1582-07-1-2039	59,477
Policy-Governed Data Fusion	12.630	W911NF-07-2-0088	162,757
<u>Passed through Florida Technological Institute</u>			
Biologically Inspired Security Infrastructure for Tactical Environments Year 2	12.630	W911NF-08-2-0023	32,290
<u>Passed through Bucknell University</u>			
Unmanned Ground Vehicle Mobility in Urban Terrain	12.800	N00014-08-1-0953	94,562
Total Office of Naval Research			<u>3,768,769</u>
<u>Army Research Laboratory</u>			
Agile Computing for Army Future Combat Missions	12.431	W911NF-05-2-0051	113,420
<u>Passed through University of Central Florida</u>			
Team Performance and Optimization in Human-Agent Collaboration	12.114	W911NF-06-2-0041	407,899
Team Performance and Optimization in Human-Agent Collaboration - Year 2	12.114	W911NF06-2-0041	53,700
<u>Passed through Florida Institute of Technology</u>			
Biologically Inspired Security Infrastructure for Tactical Environments	12.630	W911NF-07-2-0022	334,579
Total Army Research Laboratory			<u>909,598</u>

FLORIDA INSTITUTE FOR HUMAN AND MACHINE COGNITION, INC.
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2008
(Continued)

Federal Grantor, Pass-through Grantor, Program or Cluster Title	CFDA Number	Pass-through Agency's Identifying Number	Federal Expenditures
<u>Department of the Air Force,</u>			
Air Force Research Laboratory			
Agile Computing Air Force Information Management Infrastructure	12.800	FA8750-06-2-0064	106,928
Process Integrated Mechanism for Human-Computer Collaboration and Coordination	12.800	FA9550-08-1-0218	134,425
Seamless and Secure Federation Among Highly-and-Loosely-Connected Infospaces	12.800	FA8750-07-2-0174	241,307
A Cross-Layer Communication Substrate for Tactical Information Management Systems	12.800	FA8750-07-2-0185	189,781
Air Force Office of Scientific Research, Passed through Dartmouth College			
On the Effects of Culture and Society on Adversarial Attitudes and Behaviors	12.800	5-36195-5710	11,369
Total Department of the Air Force			<u>683,810</u>
<u>Defense Advanced Research Projects Agency</u>			
Urban Warrior Robot: A Reconfigurable Robot for Urban Operations	12.910	HR0011-05-C-0070	5,988
Integrated Learning from Observation, Language, and Practice	12.910	HR0011-06-1-0035	256,569
Passed through SRI International			
Cognitive Assistant that Learns and Observes - Year 4	12.910	55-000767	232,321
Cognitive Assistant that Learns and Observes - Year 5	12.910	NBCHD030010	364,178
Total Defense Advanced Research Projects Agency			<u>859,056</u>
<u>National Aeronautics and Space Administration,</u>			
Ames Research Center			
Composing the Right Mix of Humans and Technology for Lunar Surface Exploration	43.001	NNA06CB46A	50,630
Flexible Roving Exploration Device Study	43.001	NNX07AT78G	121,592
Total National Aeronautics and Space Administration			<u>172,222</u>

FLORIDA INSTITUTE FOR HUMAN AND MACHINE COGNITION, INC.
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2008
(Continued)

Federal Grantor, Pass-through Grantor, Program or Cluster Title	CFDA Number	Pass-through Agency's Identifying Number	Federal Expenditures
<u>National Science Foundation</u>			
Issues in Maintaining Scientific Integrity in Application of Automated Methodology	47.075	SES-0551833	8,112
IKL Reasoning Engine	47.070	HS-0742022	110,723
Total National Science Foundation			<u>118,835</u>
<u>National Institutes of Health</u>			
Passed through the University of Pittsburgh			
Novel Glaucoma Diagnostics for Structure and Function	93.867	NIH 2 R01 EY013178-06	17,562
Total Research and Development Cluster and Expenditures of Federal Awards			<u>\$ 6,529,852</u>

NOTE: This schedule is presented on the accrual basis of accounting in accordance with generally accepted accounting principles.

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

To the Board of Directors
Florida Institute for Human and Machine Cognition, Inc.
Pensacola, Florida

We have audited the financial statements of Florida Institute for Human and Machine Cognition, Inc. (IHMC) (a nonprofit organization) as of and for the year ended June 30, 2008, and have issued our report thereon dated October XX, 2008. 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 IHMC'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 IHMC's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of IHMC's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified a certain deficiency in internal control over financial reporting that we consider to be a significant deficiency.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects IHMC's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles, such that there is more than a remote likelihood that a misstatement of the IHMC's financial statements that is more than inconsequential will not be prevented or detected by IHMC's internal control. We consider the deficiency described in the accompanying schedule of findings and questioned costs as item 2008-1 to be a significant deficiency in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by IHMC's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiency described above is not a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether IHMC's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants 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*.

IHMC's response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit IHMC's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of IHMC's management, the audit committee, the Board of Directors, and federal awarding agencies and pass-through entities, and is not intended to be and should not be used by anyone other than these specified parties.

Pensacola, Florida
October XX, 2008

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE
WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM
AND ON INTERNAL CONTROL OVER COMPLIANCE IN
ACCORDANCE WITH OMB CIRCULAR A-133**

To the Board of Directors
Florida Institute for Human and Machine Cognition, Inc.
Pensacola, Florida

Compliance

We have audited the compliance of the Florida Institute for Human and Machine Cognition, Inc. (IHMC) (a nonprofit organization) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2008. IHMC's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of IHMC's management. Our responsibility is to express an opinion on IHMC'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 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 a major federal program occurred. An audit includes examining, on a test basis, evidence about IHMC'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 on IHMC's compliance with those requirements.

In our opinion, IHMC complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2008.

Internal Control Over Compliance

The management of IHMC is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered IHMC's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, 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 IHMC's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in entity's internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified a certain deficiency in internal control over compliance that we consider to be a significant deficiency.

A *control 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 noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiency in internal control over compliance described in the accompanying schedule of findings and questioned costs as item 2008-2 to be a significant deficiency.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. The significant deficiency in internal control over compliance described in the accompanying schedule of findings and questioned costs as item 2008-2 is not considered to be a material weakness.

IHMC's response to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit IHMC's response and, accordingly, we express no opinion on it.

This report is intended for the information and use of management, the audit committee, the Board of Directors, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

FLORIDA INSTITUTE FOR HUMAN AND MACHINE COGNITION, INC.
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2008

A. SUMMARY OF AUDITOR'S RESULTS

1. The auditor's report expresses an unqualified opinion on the financial statements of the Florida Institute for Human and Machine Cognition, Inc.
2. One significant deficiency disclosed during the audit of the financial statements is reported in the Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*. The condition is not reported as a material weakness.
3. No instances of noncompliance material to the financial statements of the Florida Institute for Human and Machine Cognition, Inc., which would be required to be reported in accordance with *Government Auditing Standards*, were disclosed during the audit.
4. One significant deficiency relating to the audit of the major federal award programs is reported in the Independent Auditor's Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133. The condition is not reported as a material weakness.
5. The auditor's report on compliance for major federal award programs for the Florida Institute for Human and Machine Cognition, Inc. expresses an unqualified opinion on all major federal programs.
6. Audit findings that are required to be reported in accordance with Section 510(a) of OMB Circular A-133 are reported in this Schedule.
7. The programs tested as major programs included the following:

Research and Development Cluster:

Collaborative Research and Development	CFDA No. 12.114
Basic and Applied Scientific Research	CFDA No. 12.300
Basic Scientific Research	CFDA No. 12.431
Basic, Applied, and Advanced Research in Science and Engineering	CFDA No. 12.630
Air Force Defense Research Sciences Program	CFDA No. 12.800
Research and Technology Development	CFDA No. 12.910
Aerospace Education Services Program	CFDA No. 43.001
Computer and Information Science and Engineering	CFDA No. 47.070
Social, Behavioral and Economic Sciences	CFDA No. 47.075
Vision Research	CFDA No. 93.867

8. The threshold used for distinguishing between Type A and B programs was \$300,000.
9. Florida Institute for Human and Machine Cognition, Inc. was determined to be a low-risk auditee.

FLORIDA INSTITUTE FOR HUMAN AND MACHINE COGNITION, INC.
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2008
(Continued)

B. FINDINGS - FINANCIAL STATEMENTS AUDIT

Significant Deficiency

2008-1 - Information Technology Controls

Auditor's comment:

During our audit process related to information technology controls, we noted that IHMC does not have formal policies covering network policy, disaster recovery, microcomputer usage, or information systems security. In addition, it does not appear that IHMC has completed an IT/IS risk assessment to include an assessment of all identified risk areas as well as any risk mitigation currently in place. The assessment should be reviewed and updated at least annually and prior to implementation of any system changes that would alter the risk profile.

We noted the system account passwords are not required to conform to industry standard best practice recommendations for password complexity or change frequency. To increase security and prevent unauthorized access we recommend that all system accounts be configured with security settings that require complex passwords with a minimum change frequency of 60 days.

We also noted IHMC procedures do not require encryption for laptop hard drives and other portable data devices (Thumb drives, PDAs, Smart phones, Portable hard drives, etc.). Adding this encryption to laptops and portable devices add the necessary security to ensure sensitive information is not compromised in the event that a laptop or portable device is lost or stolen.

Management's response:

IHMC has drafted a formal IT policy that specifically addresses the audit concerns and will incorporate it into its existing policies and procedures. Additionally, IHMC is currently documenting its IT/IS risk assessment to include an assessment of all identified risk areas as well as any risk mitigation currently in place.

FLORIDA INSTITUTE FOR HUMAN AND MACHINE COGNITION, INC.
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2008
(Continued)

C. FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL PROGRAMS AUDIT

Significant Deficiency

2008-2 Subrecipient Monitoring

Auditor's comment:

During our audit process, we noted that IHMC did not sufficiently monitor subrecipient awards. Although IHMC's agreements for services require subrecipients to provide audit and compliance reports, certain program managers for federal grants did not sufficiently monitor the receipt of these reports. In accordance with U.S. Office of Management and Budget (OMB) Circular A-110, federal funds passed through to a subrecipient should be appropriately monitored and the subrecipient should be properly informed of all grant requirements, including the need for an audit when required.

We recommend that the Director of Sponsored Research in conjunction with the federal award program managers monitor the audit requirements of subrecipients, including the related audit report submissions, to ensure proper maintenance of federal pass-through awards.

Management's response:

IHMC has developed a method to monitor its subrecipients with respect to their A-133 audit responsibilities.



REPORT ON COMPLIANCE WITH BOND RESOLUTION

To the Board of Directors
Florida Institute for Human and Machine Cognition, Inc.
Pensacola, Florida

We have audited the financial statements of Florida Institute for Human and Machine Cognition, Inc. (IHMC) (a nonprofit organization) as of and for the year ended June 30, 2008, and have issued our report thereon dated October XX, 2008. 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.

In connection with our audit, nothing came to our attention that caused us to believe that IHMC failed to comply with the covenants of the resolution relating to the Revenue Bonds (Florida Institute for Human and Machine Cognition, Inc. Project), Series 2008 issued by the Pensacola-Escambia County Promotion and Development Commission as they relate to accounting matters. However, our audit was not directed primarily toward obtaining knowledge of such noncompliance.

This report is intended solely for the information and use of management, the audit committee, the Board of Directors, and the Pensacola-Escambia County Promotion and Development Commission, and is not intended to be and should not be used by anyone other than these specified parties.

Pensacola, Florida
October XX, 2008