

**MC LAUGHLIN RESEARCH INSTITUTE FOR
BIOMEDICAL SCIENCES, INC.**

GREAT FALLS, MONTANA

FINANCIAL STATEMENTS

JUNE 30, 2006

With

INDEPENDENT AUDITORS' REPORT

McLAUGHLIN RESEARCH INSTITUTE FOR BIOMEDICAL SCIENCES, INC.
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Hamilton Misfeldt & Company P.C.

Certified Public Accountants

INDEPENDENT AUDITORS' REPORT

BOARD OF TRUSTEES
MC LAUGHLIN RESEARCH INSTITUTE
FOR BIOMEDICAL SCIENCES, INC.
GREAT FALLS, MONTANA

We have audited the accompanying statement of financial position of McLaughlin Research Institute for Biomedical Sciences, Inc. for Biomedical Sciences, Inc. (a non-profit organization) as of June 30, 2006, and the related statements of activities, functional expenses, and cash flows for the year then ended. These financial statements are the responsibility of McLaughlin Research Institute for Biomedical Sciences, Inc.'s management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit 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 audit provides 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 McLaughlin Research Institute for Biomedical Sciences, Inc. as of June 30, 2006, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 7, 2006, on our consideration of McLaughlin Research Institute for Biomedical Sciences, Inc.'s internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. 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 read in conjunction with this report in considering the results of our audit.

Our audit was performed for the purpose of forming an opinion on the basic financial statements of McLaughlin Research Institute for Biomedical Sciences, Inc. taken as a whole. The accompanying schedule of expenditures of federal awards is presented for the purpose 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. Also, the accompanying other supplementary schedules, although not necessary for the fair presentation of the financial position or results of operations of McLaughlin Research Institute for Biomedical Sciences, Inc. at June 30, 2006, for the year then ended, are presented only as supplementary information. The schedule of expenditures of federal awards and the other supplementary schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements, and, in our opinion, are fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

Hamilton Misfeldt & Company, P.C.
HAMILTON MISFELDT & COMPANY, P.C.

September 7, 2006

McLAUGHLIN RESEARCH INSTITUTE FOR BIOMEDICAL SCIENCES, INC.
STATEMENT OF FINANCIAL POSITION
June 30, 2006

ASSETS

CURRENT ASSETS

Cash and cash equivalents	\$ 1,308,611	
Accounts receivable	889	
Grants receivable	2,711,972	
Contributions receivable	153,563	
Prepaid expenses and inventories	<u>67,879</u>	\$ 4,242,914

RESTRICTED CASH AND INVESTMENTS

Cash restricted for building expansion	90,000	
Certificates of deposit	796,961	
Other investments	249,565	
Annuities	56,423	
Long-term investments - endowment	<u>3,113,551</u>	4,306,500

PROPERTY AND EQUIPMENT

Land	25,000	
Building	6,730,000	
Equipment	<u>2,753,600</u>	
	9,508,600	
Accumulated depreciation	<u>(2,866,657)</u>	6,641,943

OTHER ASSETS

46,970

Total assets

\$ 15,238,327

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES

Current portion of long-term debt	\$ 61,841	
Accounts payable	261,987	
Accrued vacation	59,557	
Other liabilities	49,987	
Deferred contractual grant revenue	<u>2,551,190</u>	\$ 2,984,562

LONG-TERM LIABILITIES

Annuity obligations	22,916	
Notes payable	<u>413,535</u>	436,451

NET ASSETS

Unrestricted	8,788,684	
Temporarily restricted	777,454	
Permanently restricted	<u>2,251,176</u>	<u>11,817,314</u>

Total liabilities and net assets

\$ 15,238,327

See accompanying notes to financial statements.

McLAUGHLIN RESEARCH INSTITUTE FOR BIOMEDICAL SCIENCES, INC.
STATEMENT OF ACTIVITIES
For the Year Ended June 30, 2006

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
REVENUES, GAINS AND SUPPORT				
Grants	\$ 4,976,008	\$ -	\$ -	\$ 4,976,008
Contributions	618,274	123,206	20,995	762,475
Investment income	179,050	1,011	-	180,061
Net unrealized and realized gains on investments	179,452	1,513	-	180,965
Gain (loss) from sale of equipment	(1,721)	-	-	(1,721)
Miscellaneous income	2,755	-	-	2,755
Net assets released from restrictions	<u>50,024</u>	<u>(50,024)</u>	<u>-</u>	<u>-</u>
 Total revenues, gains and support	 <u>6,003,842</u>	 <u>75,706</u>	 <u>20,995</u>	 <u>6,100,543</u>
EXPENSES				
Scientific research	4,286,179	-	-	4,286,179
Research support				
Management and general	1,743,320	-	-	1,743,320
Fundraising	<u>123,743</u>	<u>-</u>	<u>-</u>	<u>123,743</u>
 Total expenses	 <u>6,153,242</u>	 <u>-</u>	 <u>-</u>	 <u>6,153,242</u>
CHANGE IN NET ASSETS	<u>(149,400)</u>	<u>75,706</u>	<u>20,995</u>	<u>(52,699)</u>
Net assets at beginning of year	8,878,427	761,405	2,230,181	11,870,013
Prior period adjustments	<u>59,657</u>	<u>(59,657)</u>	<u>-</u>	<u>-</u>
 Net assets at beginning of year, as restated	 <u>8,938,084</u>	 <u>701,748</u>	 <u>2,230,181</u>	 <u>11,870,013</u>
NET ASSETS AT END OF YEAR	<u>\$ 8,788,684</u>	<u>\$ 777,454</u>	<u>\$ 2,251,176</u>	<u>\$ 11,817,314</u>

See accompanying notes to financial statements.

McLAUGHLIN RESEARCH INSTITUTE FOR BIOMEDICAL SCIENCES, INC.
STATEMENT OF FUNCTIONAL EXPENSES
For the Year Ended June 30, 2006

	<u>Research Support</u>			
	<u>Scientific Research</u>	<u>Management and General</u>	<u>Fundraising</u>	<u>Total</u>
Salaries and wages	\$ 1,336,423	\$ 412,169	\$ 55,232	\$ 1,803,824
Payroll taxes and staff benefits	<u>368,951</u>	<u>194,927</u>	<u>16,034</u>	<u>579,912</u>
	1,705,374	607,096	71,266	2,383,736
Advertising	-	-	8,668	8,668
Animal care and services	170,087	-	-	170,087
Bid and proposal	-	824	-	824
Board of trustees and committees	-	20,430	3,332	23,762
Conferences and seminars	-	16,648	-	16,648
Contracted personnel	-	1,675	4,115	5,790
Depreciation	137,811	376,694	-	514,505
Dues	-	8,750	250	9,000
Fundraising expenses	-	-	24,419	24,419
Hazardous waste/radiation safety	-	10,969	-	10,969
Insurance	-	36,190	-	36,190
Interest on remodel loan	-	7,757	-	7,757
Internet	-	11,128	-	11,128
Laundry and cleaning	-	9,225	-	9,225
Legal and Accounting	-	14,172	-	14,172
Library (including periodicals)	-	9,089	-	9,089
Licenses and fees	-	975	-	975
Liquid nitrogen and other gases	-	24,060	-	24,060
Miscellaneous expenses	12,995	2,915	2,069	17,979
Office expenses	-	36,939	4,636	41,575
Postage and freight	16,053	4,039	2,100	22,192
Recruiting and relocating	-	34,065	-	34,065
Repairs and maintenance - building	-	81,950	-	81,950
Repairs and maintenance - equipment	-	58,182	-	58,182
Scholarships	12,750	-	-	12,750
Small equipment	519	25,973	-	26,492
Special event expenses	-	-	171	171
Sub-grant expenditures	1,937,761	-	-	1,937,761
Supplies - lab	224,436	-	-	224,436
Telephone	-	12,753	167	12,920
Travel	68,393	23,883	2,550	94,826
Unallowed expenses	-	11,715	-	11,715
Utilities	<u>-</u>	<u>295,224</u>	<u>-</u>	<u>295,224</u>
	<u>\$ 4,286,179</u>	<u>\$ 1,743,320</u>	<u>\$ 123,743</u>	<u>\$ 6,153,242</u>

See accompanying notes to financial statements.

McLAUGHLIN RESEARCH INSTITUTE FOR BIOMEDICAL SCIENCES, INC.
STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2006

CASH FLOWS FROM OPERATING ACTIVITIES

Change in net assets	\$	(52,699)	
Adjustments to reconcile change in net assets to net cash used in operating activities:			
Depreciation		514,505	
Net unrealized and realized gains on investments		(180,965)	
Gain (loss) from sale of equipment		1,721	
Change in:			
Accounts receivable		17,972	
Grants receivable		(97,233)	
Contributions receivable		(90,000)	
Prepaid expenses and inventories		414	
Other assets		(3,421)	
Accounts payable		(91,160)	
Accrued vacation		59,556	
Other liabilities		(116,313)	
Deferred contractual grant revenue		(313,537)	
Annuity obligations		22,916	
Contributions restricted for long-term purposes		<u>(110,995)</u>	\$ (439,239)

CASH FLOWS FROM INVESTING ACTIVITIES

Purchase of property and equipment	(68,813)	
Change in cash restricted for building expansion	(90,000)	
Purchase of investments	(2,064,993)	
Proceeds from sale of investments	<u>1,119,108</u>	(1,104,698)

CASH FLOWS FROM FINANCING ACTIVITIES

Payments on notes payable	(62,514)	
Collections of contributions restricted for building expansion	90,000	
Collections of contributions restricted for investment in endowment	<u>20,995</u>	<u>48,481</u>

NET DECREASE IN CASH AND CASH EQUIVALENTS (1,495,456)

Cash and cash equivalents at beginning of year 2,804,067

CASH AND CASH EQUIVALENTS AT END OF YEAR \$ 1,308,611

SUPPLEMENTAL CASH FLOW DISCLOSURES:

Interest paid \$ 15,545

See accompanying notes to financial statements.

McLAUGHLIN RESEARCH INSTITUTE FOR BIOMEDICAL SCIENCES, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2006

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Activities

McLaughlin Research Institute for Biomedical Sciences, Inc. (the Institute) is engaged in biomedical research in the areas of genetics and immunology and in conducting other forms of medical research involving life-threatening diseases. The Institute is supported primarily through federal grants and donor contributions.

Income Tax Status

The Institute is a nonprofit organization as described in Section 501(c)(3) of the Internal Revenue Code and is exempt from federal and state income taxes.

Basis of Accounting

The financial statements of the Institute have been prepared on the accrual basis of accounting and accordingly reflect all significant receivables, payables, and other liabilities.

Basis of Presentation

Financial statement presentation follows the recommendations of the Financial Accounting Standards Board in its Statement of Financial Accounting Standards (SFAS) No. 117, *Financial Statements of Not-for-Profit Organizations*. Under SFAS No. 117, the Institute is required to report information regarding its financial position and activities according to the three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

Unrestricted net assets include resources that are not temporarily or permanently restricted by the donor and are available for operations of the Institute without limitation. Unrestricted net assets also include resources restricted by donor-imposed criteria for which the restrictions are met within the same time period as the funds are received.

Temporarily restricted net assets include those resources restricted by grantor-imposed criteria and which either expire with the passage of time or by actions of the Institute.

Permanently restricted net assets include those resources restricted to investment in perpetuity.

Functional Expense Allocations

Expenses relating to more than one function are allocated to scientific research and research support based on employee time estimates or other appropriate usage factors.

Estimates

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

McLAUGHLIN RESEARCH INSTITUTE FOR BIOMEDICAL SCIENCES, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2006

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Grants and Contracts

Revenue from grants and contracts is recognized as the related costs are incurred under the grant or contract agreement.

Contributions

Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support depending on the existence and/or nature of any donor restrictions. Support that is restricted by the donor is reported as an increase in temporarily or permanently restricted net assets, depending on the nature of the restriction. When a restriction expires, (that is, when a stipulated time restriction ends or purpose restriction is accomplished), temporarily restricted net assets are reclassified to unrestricted net assets and reported in the Statement of Activities as net assets released from restrictions. Those restricted and released in the same period are recorded as unrestricted.

Contributions Receivable (Promises to Give)

Unconditional promises to give are recognized as revenues or gains in the period received and as assets, decreases of liabilities, or expenses depending on the form of the benefits received. Conditional promises to give are recognized only when the conditions on which they depend are substantially met and the promises become unconditional.

Donated Equipment and Services

Donations of property and equipment are recorded as contributions at their estimated fair value at the date of donation. Such donations are reported as increases in unrestricted net assets unless the donor has restricted the donated asset to a specific purpose. Assets donated with explicit restrictions regarding their use and contributions of cash that must be used to acquire property and equipment are reported as restricted contributions. Absent donor stipulations regarding how long those assets must be maintained, the Institute reports expirations of donor restrictions when the donated or acquired assets are placed in service as instructed by the donor. The Institute reclassifies temporarily restricted net assets to unrestricted net assets at that time.

Under SFAS No. 116, *Accounting for Contributions Received and Contributions Made*, the Institute recognizes services requiring specialized skills such as those provided by accountants, attorneys, marketing consultants, and other professionals if the services would need to be purchased if not donated.

During the year ended June 30, 2006, the Institute received \$7,202 and \$1,640 in donated equipment and services, respectively.

McLAUGHLIN RESEARCH INSTITUTE FOR BIOMEDICAL SCIENCES, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2006

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Concentrations

During the year ended June 30, 2006, the Institute received approximately 53% and 19% of its revenue from the National Institutes of Health and Department of Defense, respectively.

Cash and Cash Equivalents

For purposes of the Statement of Cash Flows, the Institute considers all unrestricted, highly liquid investments with an initial maturity of three months or less to be cash equivalents.

Inventories

Inventories are stated at the lower of cost or market determined by the first in, first out method.

Investments

The Institute carries investments in marketable securities with readily determinable fair values and all investments in debt securities at their fair values in the Statement of Financial Position. Unrealized gains and losses are included in the change in net assets in the accompanying Statement of Activities.

Property and Equipment

Land, building and equipment are recorded at cost. Depreciation is computed on the straight-line method over the estimated useful lives of the assets. Assets purchased with federal or matching funds are not capitalized, but expensed in the year of purchase, according to grantor regulations. The Institute's policy is to expense property and equipment with initial costs of less than \$5,000. Estimated useful lives are as follows:

Equipment	3-10 years
Building	40 years

Deferred Contractual Grant Revenue

The Institute reports deferred contractual grant revenue on the Statement of Financial Position. It represents the portion of the grant monies to which the Institute does not yet have a legal claim. When research is performed and qualifying expenses incurred, the liability for deferred contractual grant revenue is reduced and revenue is recognized.

Advertising

The Institute uses advertising to promote its programs among the audiences it serves. Advertising costs are expensed as incurred. During the year ended June 30, 2006, advertising costs totaled \$8,668.

McLAUGHLIN RESEARCH INSTITUTE FOR BIOMEDICAL SCIENCES, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2006

NOTE 2: CASH, CASH EQUIVALENTS AND INVESTMENTS

Cash, cash equivalents and investments are carried at market value and are comprised of the following as of June 30, 2006:

	Cost	Market Value
<u>Unrestricted/Temporarily Restricted</u>		
Cash on hand	\$ 1,350	\$ 1,350
Deposits in bank	46,540	46,540
Savings deposits	617,225	617,225
Repurchase agreements	132,977	132,977
Money market funds	401,466	401,466
Certificates of deposit	996,961	996,961
U.S. Treasury notes	8,000	8,572
U.S. Government agency obligations	78,968	77,964
Corporate obligations	137,178	136,071
Mutual funds	80,623	82,434
Total unrestricted/temporarily restricted	2,501,288	2,501,560
<u>Endowment</u>		
Money market funds	42,858	42,858
U.S. Treasury notes	48,203	46,997
U.S. Government agency obligations	903,237	884,008
Corporate obligations	107,293	99,523
Mutual funds	1,615,762	2,040,165
Total endowment	2,717,353	3,113,551
Total cash, cash equivalents and investments	\$ 5,218,641	\$ 5,615,111

Cash, cash equivalents, and investments are presented in the Statement of Financial Position at June 30, 2006 as:

Cash and cash equivalents	\$ 1,308,611	
Cash restricted for building expansion	90,000	
Certificates of deposit	796,961	
Other investments	249,565	
Annuities	56,423	
Long-term investments - endowment	3,113,551	
		\$ 5,615,111

NOTE 3: CASH SURRENDER VALUE OF LIFE INSURANCE

The Institute is the policy owner of two life insurance policies which have cash surrender values at June 30, 2006 totaling \$45,893. The insurance investments are carried at the cash surrender value, which approximates fair market value. The cash surrender values are included in the Statement of Financial Position as a component of other assets.

McLAUGHLIN RESEARCH INSTITUTE FOR BIOMEDICAL SCIENCES, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2006

NOTE 4: NOTES PAYABLE

Notes payable at June 30, 2006 is summarized as follows:

Note payable to Montana Board of Investments at approximately 2.0%, with annual payments of \$25,722, secured by equipment. Matures June 2023.	\$ 367,687	
Note payable to Mountain West Bank at 5.5%, due in monthly installments of \$4,025, secured by investments. Matures December 2008.	<u>107,689</u>	\$ 475,376
Current portion of long-term debt		<u>(61,841)</u>
		<u>\$ 413,535</u>

Future maturities of long-term debt are as follows:

Year ended June 30:		
2007	\$ 61,841	
2008	64,661	
2009	37,416	
2010	19,498	
2011	19,888	
Thereafter	<u>272,072</u>	
		<u>\$ 475,376</u>

NOTE 5: LINE OF CREDIT

The Institute has a \$250,000 line of credit at Mountain West Bank which expires January 2, 2007. The interest rate is 7.75% at year-end, which is the Wall Street Journal prime adjusted quarterly. There is no outstanding balance on this line of credit at June 30, 2006.

NOTE 6: RESTRICTIONS/LIMITATIONS ON NET ASSETS

Unrestricted Net Assets

The Institute's board of trustees has chosen to place the following limitation on unrestricted net assets at June 30, 2006:

Designated for Genesis Fund (reserve)	\$ 578,534	
Designated for renewals and replacements	127,365	
Undesignated	<u>8,082,785</u>	
Unrestricted net assets		<u>\$ 8,788,684</u>

McLAUGHLIN RESEARCH INSTITUTE FOR BIOMEDICAL SCIENCES, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2006

NOTE 6: RESTRICTIONS/LIMITATIONS ON NET ASSETS (Continued)

Temporarily Restricted Net Assets

Temporarily restricted net assets are restricted by the donor and are available for the following purposes at June 30, 2006:

Student scholarships and programs	\$	53,546
Investigator recruitment		100,000
Building expansion		90,000
Genesis Fund (reserve)		430,280
Pilot program research		5,648
Cancer research		910
Charitable gift annuities		33,507
Charitable remainder unitrusts		63,563

Temporarily restricted net assets \$ 777,454

Permanently Restricted Net Assets

Permanently restricted net assets of \$2,251,176 are restricted to investment in perpetuity, the income from which is expendable to support any activities of the Institute.

NOTE 7: DEFINED CONTRIBUTION MONEY PURCHASE PENSION PLAN

On December 1, 1989, the board of trustees of the Institute approved the implementation of McLaughlin Research Institute's Defined Contribution Money Purchase Pension Plan effective January 1, 1989. An amount equal to 10% of an employee's salary is contributed by the employer. The plan covers all permanent full-time employees on December 1, 1989. For future employees, participation begins on the first of the month following three months employment. If the employee had been previously eligible for coverage by Teachers Insurance and Annuity Association (TIAA), participation begins on the first of the month following employment. This plan is funded through individually owned annuities issued by TIAA, and the College Retirement Equities Fund (CREF). Employees may designate the proportion of contribution to TIAA and CREF. Vesting is full and immediate.

A summary plan description has been provided which describes the plan. Plan contributions of 10% of regular salary means basic annual earnings exclusive of overtime pay and shall include compensation which is not currently includable in gross income by reasons of the application of Internal Revenue Code Sections 125 or 403(b).

Management has elected to contribute \$153,981 for this plan year which is included in payroll taxes and staff benefits on the Statement of Functional Expenses.

McLAUGHLIN RESEARCH INSTITUTE FOR BIOMEDICAL SCIENCES, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2006

NOTE 8: SPLIT-INTEREST AGREEMENTS

Charitable Gift Annuities

The Institute has received several charitable gift annuities in that the donor has contributed assets in exchange for distributions of a fixed amount for a specified period of time. Under these agreements, the assets are contributed from the donor directly to the Institute and are held as general assets of the Institute, and the related annuity liability is recorded as a general obligation of the Institute. Assets received are recorded at fair value on the date the agreement is recognized, and a liability equal to the present value of the future distributions is recorded. The difference between the fair value of the asset and the present value of the distribution is recognized as contribution revenue.

A summary of the terms of each charitable gift annuity at June 30, 2006 is as follows:

	Annuities (Investment)	Annuity Obligation
<i>Harriet Gray</i> - Gift and liability shared equally with the Great Falls Public Library Foundation. Received \$17,614 gift in December 2000 that provides for \$700 semi-annual payments at a rate of 8.0% for the life of Harriet Gray. Change in value for the year was \$418.	\$ 7,752	\$ 551
<i>DuElla E. Olson</i> - Received \$10,000 gift in October 2004 that provides for \$990 annual payments at a rate of 9.9% for the life of DuElla Olson. Change in value for the year was \$(37).	8,708	3,788
<i>Paul Milan Foster</i> - Received \$28,567 gift in December 2004 that provides for \$357 quarterly payments beginning December 2014 at a rate of 5.0% for the life of Paul Foster. Change in value for the year was \$2,180.	30,464	14,284
<i>Jane Chase Goodsill Hibbard</i> - Received \$10,000 gift in December 2005 that provides for \$230 quarterly payments at a rate of 9.2% for the life of Jane Hibbard. Contribution revenue and change in value for the year were \$5,242 and \$(36), respectively.	9,499	4,293
	\$ 56,423	\$ 22,916

McLAUGHLIN RESEARCH INSTITUTE FOR BIOMEDICAL SCIENCES, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2006

NOTE 8: SPLIT-INTEREST AGREEMENTS (Continued)

Charitable Remainder Unitrusts (CRUTs)

The Institute has been named a beneficiary of two charitable remainder unitrusts. The donors establish and fund these trusts and have specified that the Institute receive a stated percentage of the fair market value of the trusts upon termination. The present value attributable to the future interest of the Institute is recorded in the Statement of Activities as a temporarily restricted contribution in the year that the trust is established. In subsequent years, the change in present value is recorded as an increase or (decrease) in temporarily restricted contributions. The CRUTs are included in the Statement of Financial Position as a component of contributions receivable of \$63,563 as of June 30, 2006.

NOTE 9: ENDOWMENT FUNDS

The Endowment Fund (the Fund) exists and operates as an integral part of the Institute managed and administered by the board of trustees. The Institute is required to maintain the "historic dollar value" of the Fund, which simply means the value of the original contributions. The Institute may, however, expend all income derived from the Fund, including all appreciation on the endowment funds, regardless of whether the gains may be realized or unrealized. An external investment management organization assists the board of trustees with the management of the Fund's assets. The Fund's balance at June 30, 2006 was \$3,113,551.

The Institute is also the beneficiary of funds owned and administered by the Montana Community Foundation (the Foundation). Distributions from this fund shall be made according to the spending policy established by the Foundation's governing board; distributions made to the Institute during the year were minimal. The endowment fund balance at the Foundation at June 30, 2006 was \$6,471.

NOTE 10: PRIOR PERIOD ADJUSTMENTS

The renewals and replacement reserve had been classified as a temporarily restricted net asset account, when it should have been classified as an unrestricted/board designated net asset account. A debit to temporarily restricted net assets and a credit to unrestricted/board designated net assets in the amount of \$123,220 were made to correct this classification.

The present values to the future interest of two charitable remainder unitrusts (CRUTs) were recorded as unrestricted contributions in the years the CRUTs were established, when they should have been recorded as temporarily restricted contributions. A debit to unrestricted net assets and a credit to temporarily restricted net assets in the amount of \$63,563 were made to record this restriction.

SUPPLEMENTARY SCHEDULES

McLAUGHLIN RESEARCH INSTITUTE FOR BIOMEDICAL SCIENCES, INC.
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Year Ended June 30, 2006

<u>Funding Agency</u>	<u>Federal CFDA Number</u>	<u>Program Number</u>	<u>Grant Revenue Recognized</u>	<u>Grant Expenditures Recognized</u>
<u>Department of Health & Human Services</u>				
National Science Foundation				
PASI on Unconventional Myosins	N/A	OISE-0418592	\$ 61,281	\$ 61,281
National Institutes of Health				
Transcription Factors in Early Kidney Development	N/A	1 R01 DK64640-01	24,241	24,241
Transcription Factors in Early Kidney Development	N/A	5 R01 DK64640-02	256,824	56,824
Eya-1 and its Interacting Genes in Inner Ear Development	N/A	5 R01 DC005824-03	94,774	94,774
Eya-1 and its Interacting Genes in Inner Ear Development	N/A	5 R01 DC005824-04	308,683	308,683
Myosin I Beta Disruption & Inner Ear Structure and Function	N/A	5 R01 DC03279-08	331,668	331,668
Specific Inhibitions of Myosin-Va and -Vb	N/A	1 R01 GM066901-03	290,065	290,065
Functional Genetics of Susceptibility to Prions	N/A	5 P01 NS401997-04	49,584	49,584
Functional Genetics of Susceptibility to Prions	N/A	5 P01 NS401997-05	1,341,547	1,341,547
Genetic Control of Schwann Cell Myelination	N/A	5 R01 NS040751-05	221,462	221,462
Unconventional Myosins of the Hair Cell	N/A	5 F32 DC007331-02	46,871	46,871
National Institutes of Health				
Passed through from the University of Minnesota				
Biology of Alzheimer's Disease in Transgenic Mice	N/A	1 R01 AG026252-01	10,777	10,777
Biology of Alzheimer's Disease in Transgenic Mice	N/A	1 R01 AG026252-02	71,100	71,100
Passed through from Massachusetts General Hospital				
Anatomical Changes in Tau Transgenic Models	N/A	1 R01 AG026249-01	8,759	8,759
Anatomical Changes in Tau Transgenic Models	N/A	1 R01 AG026249-02	45,481	45,481
Passed through from Stem Cells, Inc.				
CNS Stem Cells for Alzheimer's Disease Therapy	N/A	1 R41 AG022736-01	78,324	78,324
CNS Stem Cells for Alzheimer's Disease Therapy	N/A	1 R41 AG022736-02	76,740	76,740
<u>Department of Defense</u>				
Early Host Responses to Prion Infection: Development of in Vivo and in Vitro Assays	N/A	DAMD17-03-0321	729,268	729,268
A Combinatorial Approach of Gene Silencing and Expression Profiling	N/A	DAMD17-03-1-0450	490	490
Early Host Responses to Prion Infection and Development of an In Vitro Bioassay	N/A	W81XWH-05-1-0584	458,282	458,282
			<u>\$ 4,506,221</u>	<u>\$ 4,506,221</u>

See accompanying notes to schedule of expenditures of federal awards.

McLAUGHLIN RESEARCH INSTITUTE FOR BIOMEDICAL SCIENCES, INC.
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
June 30, 2006

NOTE 1: BASIS OF ACCOUNTING

The accompanying schedule of expenditures of federal awards includes the federal grant activity of McLaughlin Research Institute and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations." Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of the basic financial statements.

NOTE 2: SUBRECIPIENTS

The total expenditures reported on the accompanying schedule of federal awards include expenditures totaling \$1,924,791 passed through to subrecipients for the reporting period.

INTERNAL CONTROL AND COMPLIANCE REPORTS



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

BOARD OF TRUSTEES
MC LAUGHLIN RESEARCH INSTITUTE
FOR BIOMEDICAL SCIENCES, INC.
GREAT FALLS, MONTANA

We have audited the financial statements of McLaughlin Research Institute for Biomedical Sciences, Inc. as of and for the year ended June 30, 2006, and have issued our report thereon dated September 7, 2006. 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 McLaughlin Research Institute for Biomedical Sciences, Inc.'s internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether McLaughlin Research Institute for Biomedical Sciences, Inc.'s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, 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 that are required to be reported under *Government Auditing Standards*.

Health and Human Services, the National Science Foundation, and the Montana Board of Investments, and is not intended to be and should not be used by anyone other than these specified parties.

Hamilton Misfeldt & Company, P.C.
HAMILTON MISFELDT & COMPANY, P.C.

September 7, 2006



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

BOARD OF TRUSTEES
MC LAUGHLIN RESEARCH INSTITUTE
FOR BIOMEDICAL SCIENCES, INC.
GREAT FALLS, MONTANA

Compliance

We have audited the compliance of McLaughlin Research Institute for Biomedical Sciences, Inc. 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, 2006. McLaughlin Research Institute for Biomedical Sciences, Inc.'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 McLaughlin Research Institute for Biomedical Sciences, Inc.'s management. Our responsibility is to express an opinion on McLaughlin Research Institute for Biomedical Sciences, Inc.'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 the Institute's compliance with those requirements and performing such other procedures, as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Institute's compliance with those requirements.

In our opinion, McLaughlin Research Institute for Biomedical Sciences, Inc. 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, 2006.

Internal Control Over Compliance

The management of McLaughlin Research Institute for Biomedical Sciences, Inc. 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 McLaughlin Research Institute for Biomedical Sciences, Inc.'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 and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants caused by errors or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended for the information of management, the board of trustees, the U.S. Department of Health and Human Services, the National Science Foundation and the Montana Board of Investments, and is not intended to be and should not be used by anyone other than these specified parties.

Hamilton Misfeldt & Company, P.C.

HAMILTON MISFELDT & COMPANY, P.C.

September 7, 2006

McLAUGHLIN RESEARCH INSTITUTE FOR BIOMEDICAL SCIENCES, INC.
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For the Year Ended June 30, 2006

Summary of Auditor Results

1. Type of auditor report issued on financial statements:
Unqualified
2. Financial statement reportable conditions identified:
None
3. Financial statement material noncompliance identified:
None
4. Major program reportable conditions identified: None
5. Type of auditor report issued on major program compliance:
Unqualified
6. Audit findings required to be reported: None
7. Major programs: Department of Health and Human Services and National Science Foundation
Cluster of Research and Development Grants
8. Type A program threshold: \$300,000 in expenditures (all federal funds are research and development grants)
9. Qualifications as low-risk auditee: No

Findings Relating to Financial Statements

None

Findings Relating to Federal Awards

None

McLAUGHLIN RESEARCH INSTITUTE FOR BIOMEDICAL SCIENCES, INC.
SCHEDULE OF PRIOR AUDIT COMMENTS
For the Year Ended June 30, 2006

There were no audit findings in the prior year which required action to be taken by McLaughlin Research Institute for Biomedical Sciences, Inc.