BATTELLE MEMORIAL INSTITUTE AND SUBSIDIARIES

OMB Circular A-133 Single Audit Report

September 30, 2006

(With Independent Auditors' Reports Thereon)

BATTELLE MEMORIAL INSTITUTE AND SUBSIDIARIES

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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*

Battelle Memorial Institute
The Board of Directors:

We have audited the consolidated financial statements of Battelle Memorial Institute and subsidiaries (Battelle) as of and for the year ended September 30, 2006, and have issued our report thereon dated December 15, 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 Battelle's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements and not to provide an opinion 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 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 consolidated 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 Battelle's consolidated 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 consolidated 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.*

We noted certain matters that we report to management of Battelle in a separate letter.

This report is intended solely for the information and use of the audit committee, management, 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.

KPMG LLP

Columbus, Ohio
December 15, 2006

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Independent Auditors' Report on Compliance With Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133

Battelle Memorial Institute
The Board of Directors:

Compliance

We have audited the compliance of Battelle Memorial Institute and subsidiaries (Battelle) 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 its major federal program for the year ended September 30, 2006. Battelle's major federal program is identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of Battelle's management. Our responsibility is to express an opinion on Battelle'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 Battelle'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 Battelle's compliance with those requirements.

In our opinion, Battelle complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended September 30, 2006. However, the results of our auditing procedures disclosed instances of potential noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as Finding 06-01.

Internal Control Over Compliance

The management of Battelle 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 Battelle'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 the internal control over compliance in accordance with OMB Circular A-133.

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We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect Battelle's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompany schedule of findings and questioned costs as Finding 06-01.

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 error 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.

Schedule of Expenditures of Federal Awards

We have audited the consolidated financial statements of Battelle as of and for the year ended September 30, 2006, and have issued our report thereon dated December 15, 2006. Our audit was performed for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the consolidated financial statements taken as a whole.

This report is intended solely for the information and use of Battelle Board of Directors, Battelle management, 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.

KPMG LLP

Columbus, Ohio
May 8, 2007
except as to paragraph 7,
which is as of December 15, 2006

BATTELLE MEMORIAL INSTITUTE AND SUBSIDIARIES
Schedule of Expenditures of Federal Awards
September 30, 2006

1. Direct Funding

Agency Code	CFDA	R&D	Federal Agency	Major Sub Agency/Program Title	Total Expenditures	Subcontracted Dollars
07	RD	Yes	Office of National Drug Control Policy	----------	$1,040,083	$207,699
10	RD	Yes	Department of Agriculture	----------	$16,166	-
11	478	Yes	Department of Commerce	Center for Sponsored Coastal Ocean Research Coastal Ocean Program	361,287	177,041
	RD	Yes	Department of Commerce	----------	2,202,864	236,576
					$2,564,151	$413,617
12	RD	Yes	Department of Defense	Air Force	24,949,524	9,833,012
		Yes	Department of Defense	Army	70,917,676	25,851,586
		Yes	Department of Defense	Navy	72,834,980	15,513,414
		Yes	Department of Defense	DoD Other	154,840,553	20,549,926
					$323,542,733	$71,747,938
14	RD	Yes	Department of Housing and Urban Development	----------	$270,418	-
15	RD	Yes	Department of Interior	----------	$1,113,956	$633,675
16	RD	Yes	Department of Justice	----------	$1,165,960	-
17	RD	Yes	Department of Labor	----------	$13,631	$7,695
20	108	Yes	Department of Transportation	Aviation Research Grants	54,722	-
	RD	Yes	Department of Transportation	Federal Highway Administration	6,645,887	3,251,249
		Yes	Department of Transportation	DOT Other	5,482,679	715,543
					$12,183,288	$3,966,792
21	RD	Yes	Department of the Treasury	----------	$919	-
42	RD	Yes	Library of Congress	----------	$4,627,648	$1,313,702
43	RD	Yes	National Aeronautics & Space Administration	----------	$6,906,036	$2,497,949
47	70	Yes	National Science Foundation	Computer and Information Science and Engineering	3,645	-
	RD	Yes			7,588	-
					$11,233	-
66	500	Yes	Environmental Protection Agency	Environmental Protection-Consolidated Research	1,377,048	76,636
	509	Yes	Environmental Protection Agency	Science To Achieve Results (STAR) Research Program	236,067	48
	511	Yes	Environmental Protection Agency	Office of Research and Development Consolidated Research/Training	183,773	-
	RD	Yes	Environmental Protection Agency	EPA National Homeland Security Research Center	4,874,456	504,297
		Yes	Environmental Protection Agency	EPA Consolidated Research	8,187	-
		Yes	Environmental Protection Agency	EPA National Exposure Research Lab	4,471,358	1,991,954
		Yes	Environmental Protection Agency	EPA National Risk Management Research Laboratory	8,244,322	408,549
		Yes	Environmental Protection Agency	EPA Office of Science Coordination & Policy	4,023,323	2,352,940
		Yes	Environmental Protection Agency	EPA Other	5,909,116	338,059
					$29,327,650	$5,672,483
77	RD	Yes	Nuclear Regulatory Commission	----------	$404,829	$70,339
81	049	Yes	Department of Energy	Office of Science Financial Assistance Program	155,352	-
	086	Yes	Department of Energy	Conservation Research and Development	500,703	-
	089	Yes	Department of Energy	Fossil Energy Research and Development	2,488,267	958,472
	RD	Yes	Department of Energy	DOE Other	3,638,264	305,874
					$6,782,586	$1,264,346
83	RD	Yes	Federal Emergency Management Agency	----------	$12,495,850	$3,864,864
93	242	Yes	Department of Health and Human Services	Mental Health Research Grants	2,063,944	1,080,497
	262	Yes	Department of Health and Human Services	Occupational Safety and Health Program	3,251	-
	273	Yes	Department of Health and Human Services	Alcohol Research Programs	696,434	87,800
	279	Yes	Department of Health and Human Services	Drug Abuse and Addiction Research Programs	91,794	-
	283	Yes	Department of Health and Human Services	Centers for Disease Control and Prevention_Investigations and Technical Assistance	42,173	-
	361	Yes	Department of Health and Human Services	Nursing Research	274,715	55,958
	399	Yes	Department of Health and Human Services	Cancer Control	47,239	(446)
	865	Yes	Department of Health and Human Services	Child Health and Human Development Extramural Research	2,038,150	4,230
	866	Yes	Department of Health and Human Services	Aging Research	31,597	4,000
	RD	Yes	Department of Health and Human Services	Center for Disease Control	24,816,732	878,574
		Yes	Department of Health and Human Services	Federal Drug Administration	2,861,024	637,321
		Yes	Department of Health and Human Services	National Cancer Institute	2,424,018	326,690
		Yes	Department of Health and Human Services	National Institute of Environmental Health Sciences	16,868	-
		Yes	Department of Health and Human Services	National Institute of Allergies & Infectious Diseases	13,458,892	-
		Yes	Department of Health and Human Services	National Institute of Health	30,321,114	48,032
		Yes	Department of Health and Human Services	DHHS Other	6,822,310	983,056
					$86,010,255	$4,105,712
97	RD	Yes	Department of Homeland Security	Transportation Security Administration	29,458,502	13,181,427
		Yes	Department of Homeland Security	Homeland Security Other	26,500,151	5,277,526
					$55,958,653	$18,458,953
			Total Direct Funding		$544,436,045	$114,225,764

(continued)

BATTELLE MEMORIAL INSTITUTE AND SUBSIDIARIES
Schedule of Expenditures of Federal Awards
September 30, 2006

2. Indirect Funding (Battelle is Sub recipient/Subcontractor)

Agency Code	CFDA	R&D	Federal Agency	Prime/Upper Tier Contractor	Total Expenditures	Subcontracted Dollars	Contract Ref.
10	RD	Yes	Department Of Agriculture	For-profit Organizations	41,334	-	3030-USDA Phase II
			Department Of Agriculture	Kansas State University	66,944	9,000	S03081
			Department Of Agriculture	Texas Agricultural Experiment Station	9,504	-	570308
					$117,782	$9,000	
11	RD	Yes	Department of Commerce	For-profit Organizations	126,151	-	5718339
		Yes	Department of Commerce	Lower Columbia River Estuary Partnership	134,870	-	
		Yes	Department of Commerce	Skagit River Watershed Council	62,652	1,000	
		Yes	Department of Commerce	JISAO/SMA Climate Impacts Group, University of Washington	1,091	-	
		Yes	Department of Commerce	Scripps Institution of Oceanography, UCSD	58,323	-	
		Yes	Department of Commerce	Northwest Maritime Center	10,957	-	
		Yes	Department of Commerce	Kitsap County	7,448	-	
		Yes	Department of Commerce	State Science & Technology Institute	5,027	-	AGREEMENT CP056541
					$406,519	$1,000	
12	630	Yes	Department of Defense	University of Maine	66,757	-	UM-S530
	RD	Yes	Department of Defense	For-profit Organizations	103,675,850	852,069	SUBCONTRACT G24101
		Yes	Department of Defense	Johns Hopkins University - Applied Physics Lab	104,112	-	SUBC NO. 912690
		Yes	Department of Defense	Lincoln University of Missouri	27,587	-	PO B0015829
		Yes	Department of Defense	Logistics Management Institute	151,172	-	SUBCONTRACT NO. 0502/TO 03
		Yes	Department of Defense	National Environmental Education & Training	25,832	-	NEETC CONTRACT
		Yes	Department of Defense	National Institute for Building Sciences	243,362	13,577	N62470-03-D-1129/47832/48061
		Yes	Department of Defense	Central Washington University	4,512	-	6492
		Yes	Department of Defense	Oregon State University	542,418	26	RF020A-A
		Yes	Department of Defense	University of Oregon	11,679	-	49507
		Yes	Department of Defense	Science Applications International Corporation (SAIC)	52,781	-	4400121598
		Yes	Department of Defense	Bowling Green State University	33,951	-	06359
		Yes	Department of Defense	Pennsylvania State University	20,721	12,308	SUBCONTRACT NO. 2981-BMI-COF-4444
		Yes	Department of Defense	Rutgers University	(1,483)	-	PURCHASE ORDER S106746
		Yes	Department of Defense	South Carolina Research Authority	165	-	PO #T-1518/IDA
		Yes	Department of Defense	SRI International	(207)	-	PO 27-000971
		Yes	Department of Defense	University of Missouri - Rolla	(94)	-	SUBCONTRACT #P201204-01
		Yes	Department of Defense	University of Utah	871,455	115,718	SUBCONTRACT AGREEMENT NO. 2406019, 2503107
					$105,830,570	$993,698	
14	RD	Yes	Department of Housing and Urban Development	For-profit Organizations	$22,521	-	HHSI-05-S-1002/WA P.O. 2005-01
15	RD	Yes	Department of the Interior	For-profit Organizations	98,258	8,250	PURCHASE ORDER 573144
		Yes	Department of the Interior	University of Vermont	3,064	-	P718736
		Yes	Department of the Interior	University of Alaska - Fairbanks	50,061	-	UAF 06-0035
					$151,383	$8,250	
16	RD	Yes		For-profit Organizations	(23,229)	-	SUB NO 02-8010-4M30-002 T.O. 3
		Yes	Department of Justice	NYPD - Office of Management Analysis & Planning	87,444	-	2003-90302
					$64,215	-	
17	RD	Yes	Department of Labor	For-profit Organizations	$2,487,025	-	SUBCONTRACT NO. AE-10843-00-30
19	RD	Yes	Department Of State	International Atomic Energy Agency	$70,381	$45,041	2004-0454-1

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BATTELLE MEMORIAL INSTITUTE AND SUBSIDIARIES
Schedule of Expenditures of Federal Awards
September 30, 2006

Agency Code	CFDA	R&D	Federal Agency	Prime/Upper Tier Contractor	Total Expenditures	Subcontracted Dollars	Contract Ref.
20	RD	Yes	Department of Transportation	For-profit Organizations	3,646,655	323,389	SUBCONTRACT NO. S512521SSD AGREEMENT
		Yes	Department of Transportation	American Association of State Highway + Transportation Officials	99,434	-	AGREEMENT NO. OP31979
		Yes	Department of Transportation	University of Iowa	144	-	DTNH22-01-D-07009 PO 4000090624 PHASE I PO 4000090637 PHASE II
		Yes	Department of Transportation	University of Michigan Transportation Research Institute	75,652	-	SUBCONTRACT F015555
		Yes	Department of Transportation	Greater Cleveland OH Reg. Transit Authority	(192)	-	SCRA SUBCONTRACT 98-00045
		Yes	Department of Transportation	National Cooperative Highway Research Program	27,336	1,787	HR 19-06
		Yes	Department of Transportation	West Virginia University	29,018	-	PROJECT C-15
					$3,878,047	$325,176	
21	RD	Yes	Department of the Treasury	For-profit Organizations	$1,220,249	($338,458)	230141
42	RD	Yes	Library Of Congress	Open World Library of Congress	$194,233	$85,206	RQ OWL20050026
43	RD	Yes	National Aeronautics & Space Administration	For-profit Organizations	1,126,087	338,168	3013592
		Yes	National Aeronautics & Space Administration	Indiana University	28,676	-	10411-0119
		Yes	National Aeronautics & Space Administration	University of Utah	10,450	-	122189
		Yes	National Aeronautics & Space Administration	Heritage College	1,196	-	43911
		Yes	National Aeronautics & Space Administration	University of California, San Diego	69,545	-	10233662
		Yes	National Aeronautics & Space Administration	University of Michigan	50,143	-	F015599
		Yes	National Aeronautics & Space Administration	Ohio Aerospace Institute	470,054	199,554	NNC05AA03A
		Yes	National Aeronautics & Space Administration	University of Maryland	19,602	-	SUBAWARD NO./PO 0000003276/ACCT NO. 00002389
		Yes	National Aeronautics & Space Administration	University of Maryland - Baltimore County	31,144	-	SUBAWARD CG0616
					$1,806,897	$537,722	
47	049	Yes	National Science Foundation	Ohio State University	12,926	-	60005440
	RD	Yes	National Science Foundation	For-profit Organizations	53,957	-	SUBCONTRACT NO. 6072-04-007
		Yes	National Science Foundation	University of Washington	30,912	-	696161
		Yes	National Science Foundation	University of California Observatories	655	-	44K-1067934
		Yes	National Science Foundation	Smith College	11,265	-	636481
		Yes	National Science Foundation	John Hopkins School of Public Health	5,445	-	8311-53712
					$115,160	-	
60	RD	Yes	Smithsonian Institution	For-profit Organizations	$21,076	-	9659-067
66	439	Yes	Environmental Protection Agency	Jamestown S'Klallam Tribe	63,808	-	46828
	RD	Yes	Environmental Protection Agency	For-profit Organizations	121,114	-	5835-21743
		Yes	Environmental Protection Agency	Lower Columbia River Estuary Partnership	39,968	-	02-2006
		Yes	Environmental Protection Agency	National Center for Environmental Research	69,137	-	AGREEMENT NO. SA4960
		Yes	Environmental Protection Agency	Ohio State University School of Public Health	92,459	-	PO NUMBER RF00901058 AND CLIENT PROJECT NUMBER RF741004
		Yes	Environmental Protection Agency	University of Arizona	(5)	-	CLIENT REF NO V901427. CLIENT EPA GRANT R 827443-01-0
		Yes	Environmental Protection Agency	University of Cincinnati	71,362	-	68-C-00-159/TO 93
		Yes	Environmental Protection Agency	University of California	1,221	-	AGREEMENT NO. SA3283 - PURCHASE ORDER 1-0000446087
					$459,064	-	
77	RD	Yes	Nuclear Regulatory Commission	For-profit Organizations	$9,745	-	LINK-NRC-ACRS-2006
81	049	Yes	Department of Energy	Drexel University	77,933	-	Project #210018
	RD	Yes	Department of Energy	For-profit Organizations	23,360,581	474,822	-101-TSA-W000-4
		Yes	Department of Energy	Washington State University	2,948	-	G000098
		Yes	Department of Energy	Commercial Vehicle Safety Alliance	58,746	-	DE-FC01-94RW00295/48108
		Yes	Department of Energy	Lower Columbia River Estuary Partnership	109,564	8,932	12-2006
		Yes	Department of Energy	Ohio Board of Regents	33,645	-	49423
		Yes	Department of Energy	Iowa State University - Iowa Energy Center	48,178	-	15 29892 00
		Yes	Department of Energy	University of Michigan	5,015	-	3000520401
		Yes	Department of Energy	University of Chicago, Division of the Biological Sciences	125,962	-	U135189
		Yes	Department of Energy	Montana State University	116,855	-	G141-06-W0831
		Yes	Department of Energy	Brown University	92,657	-	1544-21655/P986934
		Yes	Department of Energy	FutureGen Industrial Alliance, Inc.	4,336,166	863,602	50050
		Yes	Department of Energy	Ohio Department of Coal Development	9,785	-	GRANT AGREEMENT NO. CDO/D-99-16
		Yes	Department of Energy	Midwest Research Institute	303,879	-	TO KAF-9-29764-28/TIER 3 TECHNICAL SERVICES
		Yes	Department of Energy	SM Stoller	2,208,956	484	STLR-3730-002CP
					$30,890,870	$1,347,840	
83	RD	Yes	Federal Emergency Management Agency	For-profit Organizations	3,839	-	BCO PROPOSAL NO. CP056688
		Yes	Federal Emergency Management Agency	Virginia Polytechnic Institute & State University	33,543	-	CR 19615-425443
					$37,382	-	

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BATTELLE MEMORIAL INSTITUTE AND SUBSIDIARIES
Schedule of Expenditures of Federal Awards
September 30, 2006

Agency Code	CFDA	R&D	Federal Agency	Prime/Upper Tier Contractor	Total Expenditures	Subcontracted Dollars	Contract Ref.
93	113	Yes	Department of Health and Human Services	University of Washington	6,057	-	939044
	113	Yes	Department of Health and Human Services	University of Washington	97,857	-	UW CONTRACT NO. 238992
	113	Yes	Department of Health and Human Services	University of Idaho	91,613	-	ABK147-04-B
	121	Yes	Department of Health and Human Services	University of Washington	123,416	-	AGREMENT NO. 151979
	847	Yes	Department of Health and Human Services	Oregon Health & Science University	7,329	-	46328
	859	Yes	Department of Health and Human Services	Rutgers University	770	-	S492970 / 1865
	859	Yes	Department of Health and Human Services	----------	448,521	-	4-21451
	859	Yes	Department of Health and Human Services	Massachusetts General Hospital	285,926	-	44301
	865	Yes	Department of Health and Human Services	Center for Demography and Ecology Study	4,214	-	800877
	866	Yes	Department of Health and Human Services	University of California-Los Angeles	10,442	-	5 P50 AG005142-23
	866	Yes	Department of Health and Human Services	Washington State University (Tri Cities)	47,301	-	S/K# G001314
	867	Yes	Department of Health and Human Services	University of Southern California	1,554,841	-	AGREEMENT NO. H33447
	RD	Yes	Department of Health and Human Services	For-profit Organizations	4,892,395	-	280-05-0122
		Yes	Department of Health and Human Services	Auburn University	262,575	-	PO NO. P401892/P501083/P0000917
		Yes	Department of Health and Human Services	Brandeis University	13,246	-	SUBCONTRACT AGREEMENT
		Yes	Department of Health and Human Services	Colorado State University	30,732	-	SUBAWARD NO. G-7620-2
		Yes	Department of Health and Human Services	Duke University	155,093	-	303-1505
		Yes	Department of Health and Human Services	St Louis University	47,950	-	1 R01 HS014007-01A1
		Yes	Department of Health and Human Services	University of Washington	135,539	3,550	831470
		Yes	Department of Health and Human Services	University of Washington	100,928	5,430	565961
		Yes	Department of Health and Human Services	University of Washington	390,393	-	129928
		Yes	Department of Health and Human Services	University of Southern California	344,571	-	AGREEMENT NO. H31676
		Yes	Department of Health and Human Services	Johns Hopkins University	1,989,354	-	COOP AGREEMENT #U10 EY14483/P.O. #54792
		Yes	Department of Health and Human Services	King County Washington Department of Public Health	33,099	-	T02296T
		Yes	Department of Health and Human Services	National Association of County & City Health Officials	171,970	-	2005-061601
		Yes	Department of Health and Human Services	Syracuse University	2	-	P.O. #R0000083373
		Yes	Department of Health and Human Services	Trustees of Columbia University	14,082	-	5 R01 ES11379/539916
		Yes	Department of Health and Human Services	The Molecular Sciences Institute	210,917	-	400-30-5
		Yes	Department of Health and Human Services	Fred Hutchinson Cancer Research Center	354,333	-	579841
		Yes	Department of Health and Human Services	Oregon Health Science University	1,140	-	8409441B
		Yes	Department of Health and Human Services	Oregon Health Science University	118,636	-	44690
		Yes	Department of Health and Human Services	Oregon Health Sciences University	2,609	-	8409441A
		Yes	Department of Health and Human Services	Stanford Genome Technology Center, Stanford University	200,492	-	41556
		Yes	Department of Health and Human Services	University of Kansas Center for Research, Inc.	128,368	-	FY2002-089
		Yes	Department of Health and Human Services	University of Alabama at Birmingham	138,635	-	5 P01 ES011617-03
		Yes	Department of Health and Human Services	University of Maryland School of Medicine	292	-	S01766
		Yes	Department of Health and Human Services	University of California, Los Angeles	203,671	-	1490 G GE528
		Yes	Department of Health and Human Services	Science Applications International Corporation (SAIC)	221,893	-	25XS118
		Yes	Department of Health and Human Services	The Urban Institute	70,328	-	07542-000-00-BMI-01
		Yes	Department of Health and Human Services	University of California-Berkeley	13,238	12,000	AGREEMENT NO. SA3218-32094PG
		Yes	Department of Health and Human Services	University of Chicago	173,420	-	UIC NIH GRANT R21 A1052933
		Yes	Department of Health and Human Services	University of Minnesota	(17,223)	-	H6636422101 (YR 1) - H6636422102 (YR 2)
		Yes	Department of Health and Human Services	University of North Carolina	1,286,081	-	1 U01 DE017018-01
					$14,367,046	$20,980	
97	RD	Yes	Department of Homeland Security	For-Profit Organizations	1,989,658	162,970	SUBCONTRACT NO. 4400117645
		Yes	Department of Homeland Security	South Carolina Research Authority	1,970	-	AGR # 48569
					$1,991,628	$162,970	
99	RD	Yes	Miscellaneous	BOARD OF REGENTS OF THE UNIV OF NEBRASKA	93,272	49,830	TSA #OP36159/25-6805-003-007
			Miscellaneous	COLUMBUS OH HEALTH DEPT	67,462	-	PO #90 2005 EL005097
			Miscellaneous	ILLINOIS CLEAN COAL INSTITUTE	225,388	93,765	SUBGRANT AGMT NO. ICCI 04-1/3.2D-1
			Miscellaneous	MONTANA DEPARTMENT OF TRANSPORTATION	105,538	16,802	CONTRACT #307040
			Miscellaneous	NY DEPT OF ENVIRONMENTAL CONSERVATION	36,394	-	AGREEMENT NO. OP36212R
			Miscellaneous	OH DEPT OF DEVELOPMENT	333,736	-	GRANT AGREEMENT NO. TECH 06-004/04-013
			Miscellaneous	OH DEPT OF DEVELOPMENT	548,890	-	GRANT NO. 06-33
			Miscellaneous	OH DEPT OF JOB + FAMILY SERVICES	730,805	160,745	PO #W6014G, TASK ORDER #TO05002, RFP #0A04010
			Miscellaneous	OH OFFICE OF INFORMATION TECHNOLOGY	445,915	427,980	PURCHASE ORDER NO. FY06010, FY6017 & FY6052
			Miscellaneous	OH OFFICE OF INFORMATION TECHNOLOGY	823,492	772,487	PURCHASE ORDER NO. FY06010, FY6017 & FY6052
			Miscellaneous	STATE OF CONNECTICUT	100,815	-	NANOTECHNOLOGY INITIATIVE, OP32438
			Miscellaneous	STATE OF CONNECTICUT	381,017	97,566	OP36406
			Miscellaneous	WA DEPT OF TRANSPORTATION	2,191	-	AGREEMENT NO. 253750
					$3,894,915	$1,619,175	
			Total Indirect Funding		$168,036,708	$4,817,600	
			Total Expenditures of Federal Awards		$712,472,753	$119,043,364	

(continued)

BATTELLE MEMORIAL INSTITUTE AND SUBSIDIARIES
Schedule of Expenditures of Federal Awards
September 30, 2006

3. Agency Summary

Agency Code	Federal Agency	Major Sub Agency/Program Title	Direct Expenditures	Indirect Expenditures	Total Expenditures
07	Office of National Drug Control Policy	----------	$1,040,083	-	$1,040,083
10	Department of Agriculture	----------	$16,166	$117,782	$133,948
11	Department of Commerce	----------	$2,564,151	$406,519	$2,970,670
12	Department of Defense	Air Force	24,949,524	10,064,826	35,014,350
		Army	70,917,676	70,070,787	140,988,463
		Navy	72,597,516	6,394,938	78,992,454
		DoD Other	155,078,017	19,300,019	174,378,036
			$323,542,733	$105,830,570	$429,373,303
14	Department of Housing and Urban Development	----------	$270,418	$22,521	$292,939
15	Department of Interior	----------	$1,113,956	$151,383	$1,265,339
16	Department of Justice	----------	$1,165,960	$64,215	$1,230,175
17	Department of Labor	----------	$13,631	$2,487,025	$2,500,656
19	Department Of State	----------	-	$70,381	$70,381
20	Department of Transportation	Federal Highway Administration	6,645,887	1,254,455	7,900,342
		DOT Other	5,537,401	2,623,592	8,160,993
			$12,183,288	$3,878,047	$16,061,335
21	Department of the Treasury	----------	$919	$1,220,249	$1,221,168
42	Library of Congress	----------	$4,627,648	$194,233	$4,821,881
43	National Aeronautics & Space Administration	----------	$6,906,036	$1,806,897	$8,712,933
47	National Science Foundation	----------	$11,233	$115,160	$126,393
60	Smithsonian Institution	----------	-	$21,076	$21,076
66	Environmental Protection Agency	EPA National Homeland Security Research Center	4,874,456	-	4,874,456
	Environmental Protection Agency	EPA Consolidated Research	8,187	-	8,187
	Environmental Protection Agency	EPA National Exposure Research Lab	4,471,358	-	4,471,358
	Environmental Protection Agency	EPA National Risk Management Research Laboratory	8,244,322	71,362	8,315,684
	Environmental Protection Agency	EPA Office of Science Coordination & Policy	4,023,323	-	4,023,323
	Environmental Protection Agency	EPA Other	7,706,004	387,702	8,093,706
			$29,327,650	$459,064	$29,786,714
77	Nuclear Regulatory Commission	----------	$404,829	$9,745	$414,574
81	Department of Energy	DOE Environ. Mgmt–MS	-	$6,841,869	6,841,869
	Department of Energy	DOE Other	$6,782,586	$24,049,001	30,831,587
			$6,782,586	$30,890,870	$37,673,456
83	Federal Emergency Management Agency	----------	$12,495,850	$37,382	$12,533,232
93	Department of Health and Human Services	Center for Disease Control	24,819,984	855,333	25,675,317
	Department of Health and Human Services	Federal Drug Administration	2,861,024	-	2,861,024
	Department of Health and Human Services	National Cancer Institute	2,424,018	474,008	2,898,026
	Department of Health and Human Services	National Institute for Occupational Safety and Health	-	913,402	913,402
	Department of Health and Human Services	National Institute of Environmental Health Sciences (NIEHS)	16,868	142,384	159,252
	Department of Health and Human Services	National Institute of Allergies & Infectious Diseases	13,458,892	2,513,341	15,972,233
	Department of Health and Human Services	National Institute of Health	30,321,114	7,334,971	37,656,085
	Department of Health and Human Services	DHHS Other	12,108,355	2,133,607	14,241,962
			$86,010,255	$14,367,046	$100,377,301
97	Department of Homeland Security	Transportation Security Administration	29,458,502	881,543	30,340,045
	Department of Homeland Security	Homeland Security Other	26,500,151	1,110,085	27,610,236
			$55,958,653	$1,991,628	$57,950,281
99	Miscellaneous	State/Local Government Contracts	-	$3,894,915	$3,894,915
	Total Expenditures of Federal Awards		**$544,436,045**	**$168,036,708**	**$712,472,753**

(continued)

BATTELLE MEMORIAL INSTITUTE

Notes to Schedule of Expenditures of Federal Awards

September 30, 2006

(1) Basis of Presentation

The accompanying schedule of expenditures of federal awards (the Schedule) summarizes the expenditures of Battelle Memorial Institute and subsidiaries (Battelle) under programs funded by the federal government for the year ended September 30, 2006. The Schedule has been prepared on the accrual basis of accounting.

For purposes of the Schedule, federal awards include all grants and contracts entered into directly between Battelle and agencies and departments of the federal government, as well as federal funds passed through to Battelle by other recipients. The awards are classified as a major program in accordance with the requirements of Office of Management and Budget (OMB) Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. The Schedule includes only federal funds and other federal assistance received by Battelle and denotes the federal agency that is the source of those funds. As required by OMB Circular A-133, the Schedule does not include amounts received to operate government-owned, contractor-operated facilities.

Battelle's fiscal year 2006 major program is the research and development cluster. It includes those awards that are for technology-based research and development activities and for research training. OMB Circular A-133 defines research and development as follows: research is a systematic study directed toward fuller scientific knowledge or understanding of the subject studied; development is the systematic use of knowledge and understanding gained from research directed toward the production of useful materials, devices, systems, or methods, including design and development of prototypes and processes.

(2) Summary of Significant Accounting Policies for Federal Program Expenditures

Expenditures consist of direct and indirect costs. Direct costs are those that can be easily identified with an individual federally sponsored project. The salary cost of a Lead Scientist or Technical Specialist and the materials consumed by the project are examples of direct costs.

Battelle uses indirect cost rates to charge indirect costs to individual federally sponsored projects. Indirect costs are the costs of services and resources that benefit both federally sponsored and nonsponsored projects. The rate is the result of a number of complex cost allocation procedures that Battelle uses to allocate its indirect costs to both federally sponsored and nonsponsored activities. The indirect costs allocated to federally sponsored projects are divided by the direct costs of federally sponsored projects to arrive at a rate. Before the rates are used, the Defense Contract Audit Agency must approve them.

(3) Classified Information

Due to the nature of the Research and Development that Battelle performs on behalf of the Federal Government, various contracts and project information is considered either "Top Secret", "Secret", or "Confidential". As a result, the Schedule reflects summarized data by agency in order to properly safeguard various information as required by the Federal Government.

(4) Relationship to Consolidated Financial Statements

Federal awards in the amount of $712,472,753 are reported as a portion of total project revenue in Battelle's consolidated financial statements as revenue from operations.

BATTELLE MEMORIAL INSTITUTE

Schedule of Findings and Questioned Costs

September 30, 2006

(1) Summary of Auditors' Results:

(a) The type of report issued on the consolidated financial statements: **Unqualified Opinion**

(b) Reportable conditions in internal control were disclosed by the audit of the consolidated financial statements: **None reported**
Material weaknesses: **No**

(c) Noncompliance which is material to the consolidated financial statements: **No**

(d) Reportable conditions in internal control over major program: **Yes**
Material weaknesses: **No**

(e) The type of report issued on compliance for major program: **Unqualified Opinion**

(f) Any audit findings which are required to reported under section. 510(a) of OMB Circular A-133: **Yes**

(g) Major Program: **Research and Development Cluster**

(h) Dollar threshold used to distinguish between Type A and Type B programs: **$3,000,000**

(i) Auditee qualified as a low-risk auditee under section. 530 of OMB Circular A-133: **No**

(2) **Findings Relating to the Consolidated Financial Statements Reported in Accordance with *Government Auditing Standards:*** None

BATTELLE MEMORIAL INSTITUTE

Schedule of Findings and Questioned Costs

September 30, 2006

(3) Findings and Questioned Costs relating to Federal Awards:

Finding 06-01

Federal Program – Research and Development Cluster

CFDA No. – Research and Development Cluster

Federal Grantor – Various

Federal Contract Numbers – Various

Compliance Requirement – Allowable Costs/Cost Principles

Battelle Memorial Institute (Battelle) is exempt from OMB Circular A-122 but is required to follow the Federal Acquisition Regulation (FAR). According to the FAR 31.201-2 (48 CFR Part 31), Battelle is required to have an adequate labor charging system.

Condition Found – Management of Battelle informed us that the Defense Contract Audit Agency (DCAA), Battelle's cognizant audit agency, reported that Pacific Northwest National Laboratory's (PNNL's) labor accounting system was "inadequate in part" for the period of October 2005 through December 2006. The DCAA noted the following which they contend are significant deficiencies: 1) Battelle does not account for uncompensated overtime; 2) when uncompensated overtime hours are worked, employees may use discretion to determine the number of hours recorded in a day and the cost objectives to which they are charged; and 3) employees change prior period timesheets to reflect work performed in subsequent periods without maintaining documentation. DCAA contends the deficiencies noted could result in an overstatement or an understatement of overhead rates charged by PNNL and non-compliance with Cost Accounting Standard (CAS) 418-40(c)(1). We have reviewed correspondence between PNNL and the DCAA and note that the final CAS non-compliance report is pending resolution. Approximately $39 million in federal awards were received and expended by PNNL for the fiscal year ended September 30, 2006. Of the $39 million, approximately $13 million represents labor charges from exempt employees for these awards during the fiscal year.

Questioned Costs – No specific questioned costs were noted by the DCAA.

Effect – DCAA contends the deficiencies are significant and could result in non-compliance with the Allowable Costs/Cost Principles compliance requirement, as well as Cost Accounting Standards.

Recommendation – Battelle needs to establish a labor policy to ensure compliance with the Allowable Costs/Cost Principles compliance requirement and ensure that their labor charging system is adequate to provide that costs claimed and reimbursed are allowable and allocable.

View of Responsible Official – Battelle expects the issue to be resolved in the next few months by the Pacific Northwest Site Office DOE Contracting Officer (CO) making a written determination that PNNL's labor system is adequate pending select changes in its time recording policy. There is precedent for this outcome as the last time DCAA raised this issue at PNNL (over a decade ago), the then CO made a determination of compliance based on legal interpretation of cost accounting standards thereby resolving the issue over the objections of DCAA.