



# FINANCIAL STATEMENTS AND SCHEDULES 2018 | 2017

Arrowhead Center, Inc.



New Mexico State University  
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**Arrowhead Center, Inc.**  
**(A Component Unit of New Mexico State University)**

**Table of Contents**

**Financial Statements and Schedules**  
**June 30, 2018 and 2017**

Board of Directors and Corporation Officers.....	1
Independent Auditors' Report.....	2
Management's Discussion and Analysis (unaudited).....	4

**Basic Financial Statements**

Statements of Net Position.....	7
Statements of Revenues, Expenses, and Changes in Net Position.....	8
Statements of Cash Flow.....	9
Notes to the Financial Statements.....	10

**Required Governmental Reporting**

Report of Independent Auditors on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Governmental Auditing Standards</i> .....	15
Schedule of Findings and Responses.....	17
Exit Conference.....	18

**Arrowhead Center, Inc.**  
**(A Component Unit of New Mexico State University)**

*Board of Directors and Corporation Officers*

**Ex-Officio Directors**

- Garrey Carruthers, NMSU Chancellor
- Kevin Boberg, NMSU Vice President for Economic Development
- Andrew Burke, NMSU Senior Vice President for Administration and Finance
- Donald Pope Davis, NMSU Dean, Education
- Lizbeth Ellis, NMSU General Counsel (Non-voting)
- Rolando Flores, NMSU Dean, Agricultural, Consumer, and Environmental Sciences
- Matthew Geisel, Cabinet Secretary, New Mexico Economic Development Department
- Kathy Hansen, Director and CEO, Arrowhead Center
- Debra Hicks, Chair, NMSU Board of Regents
- James Hoffman, NMSU Dean, Business
- Daniel Howard, NMSU Provost and Executive Vice President
- Enrico Pontelli, NMSU Dean, Arts and Sciences
- Lakshmi Reddi, NMSU Dean, Engineering
- Luis Vazquez, Interim NMSU Vice President for Research
- Margie Vela, Student Regent, NMSU Board of Regents
- Donna Wagner, NMSU Dean, Health and Social Services

**Non-Position Directors**

- Davin Lopez, President and CEO, Mesilla Valley Economic Development Alliance  
-Current Term: 7/01/2016 – 6/30/2018
- James Manatt, Jr., President, Providence Technologies  
-Current Term: 7/01/2016 – 6/30/2018
- Jackie Kerby Moore, Executive Director, Sandia Science and Technology Park  
-Current Term: 7/01/2016 – 6/30/2018
- Roldan Trujillo, President, RCT Advisory LLC  
-Current Term: 7/01/2016 – 6/30/2018

**Corporate Officers (July 1, 2017 – June 30, 2018)**

- |                                       |                 |
|---------------------------------------|-----------------|
| • President and Chairman of the Board | Kevin Boberg    |
| • Vice President / Secretary          | Luis Vazquez    |
| • Treasurer                           | Andrew J. Burke |
| • Chief Executive Officer             | Kathryn Hansen  |



KPMG LLP  
Two Park Square, Suite 700  
6565 Americas Parkway, N.E.  
Albuquerque, NM 87110-8179

## Independent Auditors' Report

The Board of Directors  
Arrowhead Center, Inc.  
and Mr. Wayne Johnson New Mexico State Auditor:

### *Report on the Financial Statements*

We have audited the accompanying financial statements of the Arrowhead Center, Inc. (Arrowhead), a component unit of New Mexico State University, as of and for the years ended June 30, 2018 and 2017, and the related notes to the financial statements, which collectively comprise Arrowhead's basic financial statements as listed in the table of contents.

### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditors' Responsibility*

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### *Opinion*

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Arrowhead Center, Inc., as of June 30, 2018 and 2017, and the changes in its financial position, and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.



*Emphasis of Matter*

As discussed in Note 2 to the financial statements, effective July 1, 2017, Arrowhead adopted new accounting guidance Governmental Accounting Standards Board (GASB) Statement No. 90, *Majority Equity Interests*. Our opinions are not modified with respect to this matter.

*Other Matters*

*Required Supplementary Information*

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 4–6 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*Other Reporting Required by Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 12, 2018 on our consideration of Arrowhead'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 solely 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 effectiveness of Arrowhead's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Arrowhead's internal control over financial reporting and compliance.

*KPMG LLP*

Albuquerque, New Mexico  
December 12, 2018

**Arrowhead Center, Inc.**  
**(A Component Unit of New Mexico State University)**

*Management's Discussion and Analysis*  
*For the Years Ended June 30, 2018 and 2017*  
*(Unaudited)*

This discussion and analysis of Arrowhead Center, Inc. (Arrowhead) and its financial performance provides an overview of Arrowhead's financial activities for the fiscal years ended June 30, 2018 and 2017. All accounting transactions are considered to be governmental activities for purposes of applying the Governmental Accounting Standards Board's (GASB) accounting standards.

**Financial Highlights**

Arrowhead's net position increased by \$265,622 for fiscal year 2018, primarily due to an increase in rental income and a decrease in operating expenses. In 2017, net position increased by \$117,506, primarily due to an increase in rental income and a decrease in general operating cost.

Arrowhead's operating expenses decreased by \$108,019 in fiscal year 2018, due to decreases in private contracts, personnel, and Research Park expenses. In fiscal year 2017, operating expenses decreased by \$128,543 in fiscal year 2017, due to decreases in private contracts and general operating costs.

Arrowhead's operating revenue increased by \$40,097 in fiscal year 2018, mostly due to an increase in rental income, resulting in an operating income of \$265,622. In fiscal year 2017 operating revenue increased by \$131,814, mostly due to an increase in rental income, resulting in an operating income of \$117,506.

The cash position increased in fiscal year 2018 primarily due to an increase in rental income and a decrease in Research Park expenses. The cash position increased in fiscal year 2017 primarily due to an increase in rental income and a decrease in general operating expenses.

**Using This Annual Report**

This annual report contains the following financial statements: Statements of Net Position, Statements of Revenues, Expenses, and Changes in Net Position, and Statements of Cash Flows. Arrowhead's address is: Arrowhead Center Inc., MSC 700, P.O. Box 30001, Las Cruces, NM 88003.

**Overview of the Financial Statements**

The Statement of Net Position of Arrowhead provides information about Arrowhead's overall financial status. The Statement of Revenues, Expenses, and Changes in Net Position provides information about the operating revenues and operating expenses and the non-operating revenues and non-operating expenses of Arrowhead. The Statement of Cash Flows provides information about the sources and uses of cash.

**Arrowhead Center, Inc.**  
**(A Component Unit of New Mexico State University)**

*Management's Discussion and Analysis*  
*For the Years Ended June 30, 2018 and 2017*  
*(Unaudited)*

**Reporting on Arrowhead's Activities**

**Financial Highlights**

Arrowhead's condensed financial information as of and for the years ended June 30, 2018, 2017 and 2016 are provided in the following table:

	2018	2017	2016
Current assets	\$ 1,113,231	\$ 869,740	\$ 657,076
Other assets	33,427	32,427	32,427
<b>Total assets</b>	<b>\$ 1,146,658</b>	<b>\$ 902,167</b>	<b>\$ 689,503</b>
Current liabilities	\$ 83,328	\$ 104,459	\$ 9,301
Net position	1,063,330	797,708	680,202
<b>Total liabilities and net position</b>	<b>\$ 1,146,658</b>	<b>\$ 902,167</b>	<b>\$ 689,503</b>
Operating revenues	923,398	883,301	751,487
Operating expenses	657,776	765,795	894,338
<b>Change in net position</b>	<b>265,622</b>	<b>117,506</b>	<b>(142,851)</b>
Net position, beginning of year	797,708	680,202	823,053
<b>Net position, end of year</b>	<b>\$ 1,063,330</b>	<b>\$ 797,708</b>	<b>\$ 680,202</b>



**Arrowhead Center, Inc.**  
**(A Component Unit of New Mexico State University)**

*Management's Discussion and Analysis*  
*For the Years Ended June 30, 2018 and 2017*  
*(Unaudited)*

**Statements of Net Position**

**Assets** – The majority of the assets in 2018 were in the form of cash, \$1,075,940 and the increased balance was primarily due to the increase in rental income and a decrease in operating expenses. In 2017, the majority of the assets were in the form of cash, \$823,143 and the increased balance was primarily due to the increase in rent income. All cash was held by Arrowhead's fiscal agent, New Mexico State University (NMSU).

**Liabilities and Net Position** – In 2018 and 2017, current liabilities were \$83,328 and \$104,459, respectively. The decrease in 2018 was due to decreases in amounts owed to NMSU. The 2018 net position increased by \$265,622, due to a net operating income. The increase in 2017 was due to an increases in accounts payable and unearned revenue, as well as amounts owed to NMSU. The 2017 net position increased by \$117,506, due to operating income.

**Statements of Revenues, Expenses, and Changes in Net Position**

**Revenues** – Operating revenue earned in 2018 and 2017 were derived from private contracts, royalties, license fees, and rental income.

**Expenses** – In 2018, operating expenses decreased by \$108,019 due to a decline in private contracts, personnel, and Research Park expenses; these decreases were offset in part by an increase in legal fees related to intellectual property. In 2017, operating expenses decreased by \$128,543 due to decreases in private contracts and general operating costs.

This financial report is designed to provide a general overview of Arrowhead's finances for all those with an interest in Arrowhead's finances.

**Factors Impacting Future Periods.**

The uncertainty of the general economic conditions could have a significant impact on Arrowhead.

**Arrowhead Center, Inc.**  
**(A Component Unit of New Mexico State University)**

*Statements of Net Position*  
*As of June 30, 2018 and 2017*

	2018	2017
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 1,075,940	\$ 823,143
Accounts receivable, net	35,748	43,549
Prepaid expenses	1,543	3,048
<b>Total current assets</b>	1,113,231	869,740
<b>Non-current assets</b>		
Investments	33,427	32,427
<b>TOTAL ASSETS</b>	1,146,658	902,167
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Accounts payable and other accrued liabilities	50,673	11,847
Unearned revenue	6,413	43,847
Due to NMSU	26,242	48,765
<b>TOTAL LIABILITIES</b>	83,328	104,459
<b>NET POSITION</b>		
Unrestricted	1,063,330	797,708
<b>TOTAL NET POSITION</b>	\$ 1,063,330	\$ 797,708

**Arrowhead Center, Inc.**  
**(A Component Unit of New Mexico State University)**

*Statements of Revenues, Expenses and Changes in Net Position  
For the Years Ended June 30, 2018 and 2017*

	2018	2017
<b>REVENUES</b>		
<b>Operating revenues</b>		
Rental income	815,053	717,484
Program services income	108,345	165,817
<b>Total operating revenues</b>	<u>923,398</u>	<u>883,301</u>
<b>Operating expenses</b>		
Program services	33,078	13,869
Supporting services	624,698	751,926
<b>Total operating expenses</b>	<u>657,776</u>	<u>765,795</u>
<b>Increase in net position</b>	265,622	117,506
<b>NET POSITION</b>		
Beginning of year	797,708	680,202
End of year	<u>\$ 1,063,330</u>	<u>\$ 797,708</u>

**Arrowhead Center, Inc.**  
**(A Component Unit of New Mexico State University)**

*Statements of Cash Flows*  
*For the Years Ended June 30, 2018 and 2017*

	2018	2017
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Receipts from customers	\$ 893,765	\$ 917,179
Payments to suppliers	(639,968)	(716,960)
Net cash provided by operating activities	<u>253,797</u>	<u>200,219</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of investments	(1,000)	-
Net cash used in investing activities	<u>(1,000)</u>	<u>-</u>
<b>Net Increase in Cash</b>	252,797	200,219
<b>Cash and cash equivalents - beginning of year</b>	<u>823,143</u>	<u>622,924</u>
<b>Cash and cash equivalents - end of year</b>	<u>\$ 1,075,940</u>	<u>\$ 823,143</u>
<b>Reconciliation of operating loss to net cash used by operating activities:</b>		
Operating Income	\$ 265,622	\$ 117,506
Change in assets and liabilities:		
(Increase) Decrease in Accounts receivable	7,801	(9,397)
(Increase) Decrease in Prepaid expenses	1,505	(3,048)
Increase (Decrease) in Unearned revenue	(37,434)	43,275
Increase (Decrease) in Due to NMSU	(22,523)	48,765
Increase in Accounts payable	38,826	3,118
<b>Net cash used in operating activities</b>	<u>\$ 253,797</u>	<u>\$ 200,219</u>

**Arrowhead Center, Inc.**  
**(A Component Unit of New Mexico State University)**

*Notes to Financial Statements*  
*For the Years Ended June 30, 2018 and 2017*

**Note 1 - Organization, Nature of Operations and Reporting Entity**

Arrowhead Center, Inc. (Arrowhead), formerly known as the New Mexico State University Technology Transfer Corporation, is organized pursuant to the provisions of the State of New Mexico's University Research Park Act of 1989 (Act). The purpose of the Act is to foster economic development within the State through the development of research parks or University real property, and through the cooperative ventures of innovative technological significance. Arrowhead is a component unit of New Mexico State University (the University).

A Memorandum of Agreement (MOA) between the Regents of New Mexico State University and Arrowhead has established provisions to which Arrowhead will comply. Arrowhead represents the interests of the University in all intellectual property developed by the University and its faculty for purposes of protection, licensing, and commercialization. Arrowhead's primary purposes are to promote and contribute to economic development and to aid in the transfer of innovative technology between the faculty at the University and the public. Arrowhead furthers the interests of the University by operating research park(s) for the benefit of the University and other facilities within the State of New Mexico.

Operating revenues are derived from rental income, private contracts, and license fees. Arrowhead's operating plan includes royalty fees, which should be a source of revenue in the future. Non-operating revenue was derived from Arrowhead's portion of ownership of stock in privately held investments. The rental income received by Arrowhead is on properties leased by Arrowhead from the University, see additional discussion at Note 4: Leases.

The University pays the legal fees associated with the licensing of patents, which are held in the University's name, until such time as the patent generates royalty income. Arrowhead will reimburse the University for any legal fees related to the licensing of patents generating revenues.

Arrowhead is the sole shareholder in Arrowhead Innovation Fund, GP, Inc. (GP). In 2016, GP was created as a for profit corporation to provide investment management and supervisory services to Arrowhead Innovation Fund, LP, or contract these to third parties. Arrowhead's relationship with GP is to be that of an investment, with the intention of generating cash flow and profits.

**Note 2 – Summary of Significant Accounting Policies**

**Basis of Presentation.** The Governmental Accounting Standards Board's (GASB) Statement No. 39, *Determining Whether Certain Organizations are Component Units*, provides additional guidance to determine whether certain organizations for which the primary government is not financially accountable should be reported as component units based on the nature and significance of their relationship with the primary government. GASB Statement No. 61, *Financial Reporting Entity: Omnibus - an amendment of GASB Statements No. 14 and No. 34*, improves financial reporting for governmental entities. GASB Statement No. 80, *Blending Requirements for Certain Component Units*, amends the blending requirements for the financial statement presentation of component units of all state and local governments. Based on the criteria of the above mentioned GASB statements, Arrowhead does not have any component units.

**Basis of Accounting.** The accompanying financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB).

For financial reporting purposes, Arrowhead is considered a special-purpose government engaged only in business-type activities. Accordingly, the financial statements have been presented using the

**Arrowhead Center, Inc.**  
**(A Component Unit of New Mexico State University)**

*Notes to Financial Statements*  
*For the Years Ended June 30, 2018 and 2017*

economic resources measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned and expenses are recorded when an obligation has been incurred.

**Cash and Investments.** Cash consists of cash on hand and current investments, which are defined as investments that are readily convertible to known amounts of cash or which have an original maturity date within ninety days. Cash recorded in the Statements of Net Position is held by the University in a cash management pool. As of June 30, 2018 and 2017, Arrowhead had stock of \$33,427 and \$32,427, respectively, in privately held companies including 100% ownership of GP stock. Investments in stock consist of ownership in private companies and are recorded under the cost method, in accordance with GASB 62. As operations increase, the investment in GP will be accounted for using the equity method, under GASB 90.

**Accounts Receivable.** Accounts receivable includes contracts with private companies to perform research and analysis studies and reimbursement of organizational costs from related parties. As of June 30, 2018 and 2017, Management has determined that \$36,414 is uncollectible.

**Net Position.** Arrowhead's net position is classified as follows:

*Unrestricted net position* is used for financial transactions related to the operation of Arrowhead and may be used at the discretion of the governing board.

When an expense is incurred that can be paid using either restricted or unrestricted resources, Arrowhead's policy is to first apply the expense towards restricted resources, and then towards unrestricted resources. Restricted net position includes resources which Arrowhead is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties. As of June 30, 2018 and 2017, Arrowhead had no restricted net position.

**Income Taxes.** Arrowhead is exempt from federal income tax under section 501(a) of the Internal Revenue Code (IRC) as an organization described in section 501(c)(3). However, income generated from activities unrelated to Arrowhead's exempt purpose is subject to tax under IRC Section 511. Arrowhead had no unrelated business income in 2018 and 2017.

**Classification of Revenues and Expenses.** Operating revenue and expenses are those incurred which relate directly to facilitating commercialization of the University faculty, staff and student inventions. Primary sources of revenue include rental income and contractual services income which are considered exchange transactions whereby revenue is recognized when earned according to the respective contractual agreements. Operational and patent cost funding from the University is recognized when all eligibility requirements have been met.

Patent cost reimbursement is recognized when earned. All other revenue and expenses are considered non-operating.

**Use of Estimates.** The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, and disclosure of contingent assets and liabilities, at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Budgetary Process.** Arrowhead is not required to submit its budgets to the New Mexico Higher Education Department (HED) or the New Mexico Department of Finance and Administration-State Budget Division (DFA).

**Arrowhead Center, Inc.**  
**(A Component Unit of New Mexico State University)**

*Notes to Financial Statements*  
*For the Years Ended June 30, 2018 and 2017*

**Adoption of New Accounting Pronouncement.** During the year ended June 30, 2018 Arrowhead adopted GASB Statement No. 90, *Majority Equity Interests*, an amendment of GASB Statements No. 14 and No. 61., which clarifies the treatment of majority equity interest in a legally separate organization. The adoption of this statement resulted in the recognition of a \$1,000 investment.

**Note 3 - Cash and Investments**

Arrowhead follows all University cash management and investment policies.

**Concentration of Credit Risk.** Arrowhead's only investment is stock in privately held companies that are not rated.

**Custodial Credit Risk-Deposits.** In the case of deposits, this is the risk that in the event of a bank failure, Arrowhead's deposits may not be returned to it. Arrowhead does not have a deposit policy for custodial credit risk. Arrowhead's cash balance is maintained in the University's cash pool, were \$1,075,940 and \$823,143 at June 30, 2018 and 2017, respectively.

**Note 4 – Leases**

At June 30, 2018 and 2017, Arrowhead (Lessee) had two lease agreements with the University summarized as follows:

(A) Arrowhead Research Park

**Land Rent.** The Regents of New Mexico State University and Arrowhead have established a Master Ground Lease to allow Arrowhead to lease one tract of land from the University, which is scheduled to terminate on June 30, 2075. The annual Land rent to the University shall be one-half of the net proceeds received by Arrowhead during the preceding year. Net proceeds are defined as the gross land lease revenues, received by Arrowhead, less the total of any amounts retained for operating and improvements expenses as approved in the annual development plan and budget by the University. For fiscal year 2018, Arrowhead Center Inc. recorded \$25,000 in rental expense and recognized a liability to the University. Arrowhead is unable to estimate future minimum lease payments.

Arrowhead sub-leases land in Research Park to tenants (termed sub-lessees). Arrowhead's lease income from land in Research Park, including annually renewable lease agreements, amounted to \$559,989 and \$533,984 for the years ended June 30, 2018 and 2017, respectively.

**Arrowhead Center, Inc.**  
**(A Component Unit of New Mexico State University)**

*Notes to Financial Statements*  
*For the Years Ended June 30, 2018 and 2017*

Year Ending June 30	Lease Income
2019	566,504
2020	593,375
2021	598,922
2022	604,532
2023	608,869
2024-2028	3,121,844
2029-2033	3,260,673
2034-2038	3,234,198
2039-2043	3,329,016
2044-2048	3,451,277
2049-2053	2,860,622
2054-2056	1,561,309
	<u>\$ 23,791,141</u>

(B) Genesis Center

Office Space Rent. The Regents of New Mexico State University and Arrowhead have established a Lease for four buildings known as Genesis Center, which is scheduled to terminate on June 30, 2027. The rent to the University is determined in advance for the fiscal year and paid on a monthly basis. The rent covers facilities operations and maintenance, facilities fire protection services, facilities environmental, health and safety, and indirect plan O&M support.

Arrowhead's rent expense for the Genesis Center lease amounted to \$40,844 and \$43,408 for the years ended June 30, 2018 and 2017, respectively.

The following is a schedule of future contracted lease payments, prior to annual actual billing, from Arrowhead to the University for Genesis office space at June 30, 2018:

Year Ending June 30	Lease Income
2019	63,324
2020	63,324
2021	63,324
2022	63,324
2023	63,324
2024-2027	<u>253,296</u>
	<u>\$ 569,916</u>

Arrowhead sub-leases office space in Genesis Center to tenants (termed sub-lessees). Arrowhead's lease income from office space in Genesis Center, including annually renewable lease agreements, amounted to \$255,065 and \$183,500 for the years ended June 30, 2018 and 2017, respectively.



**Arrowhead Center, Inc.**  
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*Notes to Financial Statements*  
*For the Years Ended June 30, 2018 and 2017*

The following is a schedule of minimum future lease income under lease terms exceeding one year as of June 30, 2018:

Year Ending June 30	Lease Income
2019	209,356
2020	36,650
2021	9,230
	<u>\$ 255,236</u>

**Note 5 – Related Party**

The University provides Arrowhead with various services at no charge, which primarily consists of personnel services. Support arising from the donated services of certain employees of the University is the most significant of the donated services. Such services are not recorded in the accompanying financial statements. Additionally, the University pays legal fees associated with the licensing of patents, which are in the name of the University, until Arrowhead receives the patents royalty income. If and when revenues are received, Arrowhead will reimburse the University for any legal fees paid related to the license agreement generating the revenue. At June 30, 2018 and 2017, Arrowhead was contingently liable for cumulative unreimbursed legal fees of \$3,014,686 and \$2,871,641, respectively (of which \$1,601,314 of the Arrowhead Center legal expenses was considered unrecoverable). This total has been accruing since 1989, which averages \$103,955 per year.

At June 30, 2018 and 2017, Arrowhead recognized \$25,511 and \$31,731, respectively, as accounts receivable from Arrowhead Innovation Fund for organizational costs.

**Note 6 – Risk Management**

*Property and Liability Coverage.* Arrowhead is exposed to various risks of loss from torts; thefts of, damage to, and destruction of assets; business interruption; and errors and omissions and natural disasters. Arrowhead, as a component unit of New Mexico State University, is covered through New Mexico State University's policy for liability and casualty coverage offered through the New Mexico Risk Management Division. There have been no significant reductions in coverage from the prior year and settlements have not exceeded coverage in the past three years.

**Note 7 - Subsequent Events**

Arrowhead has evaluated subsequent events from the balance sheet date through December 12, 2018, the date at which the financial statements were available to be issued, and determined there are no items to disclose.



KPMG LLP  
Two Park Square, Suite 700  
6565 Americas Parkway, N.E.  
Albuquerque, NM 87110-8179

**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***

The Board of Directors  
Arrowhead Center, Inc.  
and Mr. Wayne Johnson, New Mexico State Auditor

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of Arrowhead Center, Inc. (Arrowhead), a component of New Mexico State University, which comprise the statement of financial position as of June 30, 2018, and the related statements of revenues, expenses, and changes in net position and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated December 12, 2018.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered Arrowhead's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Arrowhead's internal control. Accordingly, we do not express an opinion on the effectiveness of Arrowhead's internal control.

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

**Compliance and Other Matters**

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

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We noted a certain matter that is required to be reported per section 12-6-5 NMSA 1978 that we have described in the accompanying schedule of other findings as required by New Mexico state statute, section 12-6-5 NMSA 1978 as item 2018-004.

**Arrowhead's Response to the Finding**

Arrowhead's response to the finding identified in our audit is described in the accompanying schedule of other findings. Arrowhead's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

**Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Arrowhead's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Arrowhead's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*KPMG LLP*

Albuquerque, New Mexico  
December 12, 2018

**Arrowhead Center, Inc.**  
**(A Component Unit of New Mexico State University)**

*Schedule of Findings and Responses*  
*For the Year Ended June 30, 2018*

**FINDINGS - FINANCIAL STATEMENT AUDIT**

**PRIOR AUDIT FINDINGS**

None

**CURRENT AUDIT FINDINGS**

**Other Findings as Required by New Mexico State Statute, Section 12-6-5, NMSA 1978**

**2018-004 Arrowhead Center, Inc. determination of accounting for majority equity interest – Finding that does not rise to the level of a significant deficiency.**

**Criteria:**

GASBC 2100 establishes standards for defining the financial reporting entity and requires governments to consider whether legally separate organizations qualify as component units.

**Condition:**

During fiscal year 2018 Arrowhead Center, Inc. (Arrowhead) became the holder of the majority equity interest with a \$1,000 investment in a separate legal entity. Becoming the majority equity interest required Arrowhead to determine the appropriate accounting for that separate legal entity in accordance with U.S. generally accepted accounting principles. This would include consideration of whether the entity qualified as a component unit and/or an investment. Management did not have a process in place to consider and document applicable accounting literature in determination of the accounting for this new transaction.

**Cause:**

Management did not fully consider all applicable accounting principles related to Arrowhead's accounting for the separate legal entity., including whether the separate legal entity qualified as a component unit and/or an investment. In addition, they did not consider the appropriate method of accounting for the investment (equity method).

**Effect:**

This lack of fully considering the applicable accounting principles could have resulted in a component unit being inappropriately excluded from the Arrowhead reporting entity.

**Recommendation:**

We recommend management consider all relevant accounting principles when entering into new transactions to ensure that the transaction and subsequent measurement/consideration of that transaction is reflected in the financial statements in accordance with U.S. generally accepted accounting principles. We further recommend that this consideration and management's conclusions be documented.

**Management's Response:**

Management will implement a documented process for new and/or significant transactions that ensures consideration of all relevant accounting principles. This process will include Arrowhead Center Inc. management and NMSU accounting personnel for a consistent and documented determination on accounting and reporting treatment of such transactions. This process will be in place by June 30, 2019.

**Arrowhead Center, Inc.**  
**(A Component Unit of New Mexico State University)**

*Exit Conference*  
*For the Year Ended June 30, 2018*

A closing conference was held on October 29, 2018, to discuss the current audit report. Our opinion is that the financial statements are materially correct. In attendance were the following individuals:

**Representing the Board of Regents Audit Committee for New Mexico State University**

Debra P. Hicks	Chair
Cindy Seipel	Audit Committee Community Member
Shari Jones	Audit Committee Community Member

**Representing Arrowhead Center, Inc.**

Kathryn Hansen	Director
Mario Naverrete	Accountant, Senior

**Representing KPMG LLP**

John T. Kennedy	Lead Engagement Partner
Suzette Longfellow	Managing Director

The University and Arrowhead's management prepared the Financial Statements. The University and Arrowhead are responsible for the Financial Statements and its contents.