

**BIOQUAL, INC. AND SUBSIDIARY**

**AUDITED CONSOLIDATED  
FINANCIAL STATEMENTS AND  
SUPPLEMENTARY INFORMATION**

**YEARS ENDED MAY 31, 2016 AND 2015**

# Bioqual, Inc. and Subsidiary

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## Independent Auditor's Report

Board of Directors  
**Bioqual, Inc. and Subsidiary**  
Rockville, Maryland

We have audited the accompanying consolidated financial statements of **Bioqual, Inc. and Subsidiary**, which comprise the Consolidated Balance Sheets as of May 31, 2016 and 2015, and the related Consolidated Statements of Income, Stockholders' Equity and Cash Flows for the years then ended, and the related notes to the financial statements.

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

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

### *Auditor's Responsibility*

Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated financial statements.

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

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## **Independent Auditor's Report (continued)**

### ***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of **Bioqual, Inc. and Subsidiary** as of May 31, 2016 and 2015, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

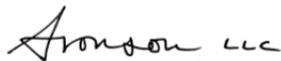
### ***Other Matters***

#### ***Other Information***

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying Schedule of Expenditures of Federal Awards, as required by Title 2 U.S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

### **Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated September 12, 2016, on our consideration of **Bioqual, Inc. and Subsidiary's** internal control over financial reporting and on our tests of their compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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 **Bioqual, Inc. and Subsidiary's** internal control over financial reporting and compliance.



Rockville, Maryland  
September 12, 2016

<i>May 31,</i>	<b>2016</b>	2015
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 5,177,529	\$ 3,708,588
Accounts receivable - contracts, net	9,323,084	7,868,626
Income taxes receivable	-	438,207
Prepaid expenses	60,062	117,485
Deferred income taxes	35,800	-
<b>Total current assets</b>	<b>14,596,475</b>	12,132,906
<b>Property and equipment</b>		
Leasehold improvements	4,486,745	4,501,410
Furniture, fixtures and equipment	8,405,396	8,202,668
<b>Total property and equipment</b>	<b>12,892,141</b>	12,704,078
Less: Accumulated depreciation and amortization	(10,070,963)	(9,717,849)
<b>Net property and equipment</b>	<b>2,821,178</b>	2,986,229
<b>Other assets</b>		
Cash surrender value of officers' life insurance	934,309	945,283
Deferred income taxes	-	179,400
Intangible assets, net	46,951	91,195
Goodwill	1,028,408	1,028,408
<b>Total other assets</b>	<b>2,009,668</b>	2,244,286
<b>Total assets</b>	<b>\$ 19,427,321</b>	\$ 17,363,421

## Bioqual, Inc. and Subsidiary

### Consolidated Balance Sheets

	2016	2015
<b>Liabilities and Stockholders' Equity</b>		
<b>Current liabilities</b>		
Note payable, current portion	\$ 302,726	\$ 288,779
Accounts payable	1,222,343	807,266
Accrued compensation and related liabilities	1,169,589	1,462,736
Income taxes payable	256,512	-
Deferred revenue	120,778	311,721
Deferred rent	-	25,477
Deferred income taxes	-	195,200
<b>Total current liabilities</b>	<b>3,071,948</b>	<b>3,091,179</b>
<b>Long term liabilities</b>		
Note payable, net of current portion	567,330	870,056
Deferred rent, net of current portion	368,925	284,027
Contingent consideration	63,500	328,900
Deferred income taxes	1,543	-
<b>Total long term liabilities</b>	<b>1,001,298</b>	<b>1,482,983</b>
<b>Total liabilities</b>	<b>4,073,246</b>	<b>4,574,162</b>
<b>Commitments and contingencies</b>		
<b>Stockholders' equity</b>		
Common stock - \$0.01 par value, 25,000,000 shares authorized; 1,599,408 shares issued at May 31, 2016 and 2015; 893,416 and 893,466 shares outstanding	15,994	15,994
Treasury stock, at cost	(1,042,135)	(1,041,297)
Additional paid-in capital	7,326,328	7,326,328
Retained Earnings	9,053,888	6,488,234
<b>Total stockholders' equity</b>	<b>15,354,075</b>	<b>12,789,259</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 19,427,321</b>	<b>\$ 17,363,421</b>

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.

## Bioqual, Inc. and Subsidiary

### Consolidated Statements of Income

<i>Years Ended May 31,</i>	<b>2016</b>	<b>2015</b>
<b>Contract revenue</b>	<b>\$ 33,060,341</b>	\$ 28,935,714
<b>Operating expenses</b>		
Contract	<b>25,497,940</b>	22,712,988
General and administrative	<b>2,841,100</b>	2,977,834
<b>Total operating expenses</b>	<b>28,339,040</b>	25,690,822
<b>Operating income</b>	<b>4,721,301</b>	3,244,892
<b>Other income (expense)</b>		
Interest income	<b>5,759</b>	3,396
Interest expense	<b>(100,231)</b>	(131,566)
Gain on disposal of property and equipment	<b>36,200</b>	2,500
<b>Total other expense</b>	<b>(58,272)</b>	(125,670)
<b>Income before income taxes</b>	<b>4,663,029</b>	3,119,222
<b>Provision for income taxes</b>	<b>1,784,662</b>	1,212,794
<b>Net income</b>	<b>\$ 2,878,367</b>	\$ 1,906,428
<b>Basic earnings per share</b>	<b>\$ 3.22</b>	\$ 2.13
<b>Diluted earnings per share</b>	<b>\$ 3.22</b>	\$ 2.13
<b>Weighted average number of shares outstanding for basic and diluted earnings per share</b>	<b>893,459</b>	893,466

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.

## Bioqual, Inc. and Subsidiary

### Consolidated Statements of Stockholders' Equity

	Common Stock		Treasury Stock		Additional Paid-In Capital	Retained Earnings	Total
	Shares	Amount	Shares	Amount			
<b>Balance, June 1, 2014</b>	1,599,408	\$ 15,994	705,942	\$ (1,041,297)	\$ 7,326,328	\$ 4,760,499	\$ 11,061,524
Dividends declared - \$.20 per share	-	-	-	-	-	(178,693)	(178,693)
Net income	-	-	-	-	-	1,906,428	1,906,428
<b>Balance, May 31, 2015</b>	1,599,408	15,994	705,942	(1,041,297)	7,326,328	6,488,234	12,789,259
Repurchase of common stock	-	-	50	(838)	-	-	(838)
Dividends declared - \$.35 per share	-	-	-	-	-	(312,713)	(312,713)
Net income	-	-	-	-	-	2,878,367	2,878,367
<b>Balance, May 31, 2016</b>	1,599,408	\$ 15,994	705,992	\$ (1,042,135)	\$ 7,326,328	\$ 9,053,888	\$ 15,354,075

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.

## Bioqual, Inc. and Subsidiary

### Consolidated Statements of Cash Flows

<i>Years Ended May 31,</i>	<b>2016</b>	<b>2015</b>
<b>Cash flows from operating activities</b>		
Net income	\$ 2,878,367	\$ 1,906,428
<b>Adjustments to reconcile net income to net cash provided by operating activities</b>		
Depreciation and amortization	692,149	850,458
Deferred income taxes	(50,057)	283,600
Change in contingent consideration payable	(265,400)	(246,100)
Gain on disposal of property and equipment	(36,200)	(2,500)
Change in cash surrender value of officers' life insurance	10,974	10,374
<b>(Increase) decrease in</b>		
Accounts receivable - contracts	(1,454,458)	(432,323)
Prepaid expenses	57,423	51,465
<b>Increase (decrease) in</b>		
Accounts payable	415,077	189,027
Accrued compensation and related liabilities	(293,147)	385,320
Income taxes payable	694,719	(565,767)
Deferred revenue	(190,943)	60,427
Deferred rent	59,421	(21,864)
<hr/>		
<b>Net cash provided by operating activities</b>	<b>2,517,925</b>	<b>2,468,545</b>
<hr/>		
<b>Cash flows from investing activities</b>		
Proceeds from sale of fixed assets	36,200	2,500
Purchases of property and equipment	(482,854)	(269,158)
Payment on officers' life insurance	-	(16,943)
<hr/>		
<b>Net cash used by investing activities</b>	<b>(446,654)</b>	<b>(283,601)</b>
<hr/>		
<b>Cash flows from financing activities</b>		
Proceeds from note payable	-	13,070
Principal payments on note payable	(288,779)	(288,779)
Dividends paid	(312,713)	(178,693)
Repurchase of common stock	(838)	-
<hr/>		
<b>Net cash used by financing activities</b>	<b>(602,330)</b>	<b>(454,402)</b>

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.

## Bioqual, Inc. and Subsidiary

### Consolidated Statements of Cash Flows (continued)

<i>Years Ended May 31,</i>	<b>2016</b>	<b>2015</b>
<b>Net change in cash and cash equivalents</b>	<b>1,468,941</b>	<b>1,730,542</b>
<b>Cash and cash equivalents at beginning of year</b>	<b>3,708,588</b>	<b>1,978,046</b>
<b>Cash and cash equivalents at end of year</b>	<b>\$ 5,177,529</b>	<b>\$ 3,708,588</b>
<b>Supplemental information:</b>		
Income taxes paid	<b>\$ 860,000</b>	<b>\$ 955,000</b>
Interest expense	<b>\$ 100,231</b>	<b>\$ 131,566</b>

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.

# Bioqual, Inc. and Subsidiary

## Notes to Consolidated Financial Statements

- 1. Organization and significant accounting policies** **Organization:** Bioqual, Inc., a Delaware Corporation, was founded in 1981. The Company supports the National Institutes of Health by providing research services in the following research areas: cancer, AIDS, hepatitis, influenza, immunology, transgenics, contraception, breeding and development of genetically defined animals, and neurobiology and behavior. The Company is headquartered in Rockville, Maryland. On February 21, 2014, the Company acquired the assets of Advanced Bioscience Laboratories, Inc. (ABL)'s in-vivo animal model services-related business.

**Principles of consolidation:** The accompanying consolidated financial statements include the accounts of Bioqual, Inc. and its wholly-owned subsidiary, Enhanced Therapeutics, Inc. (collectively, the "Company") through May 20, 2015, which is the effective date of its dissolution. All significant intercompany balances and transactions have been eliminated in consolidation.

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

**Revenue:** Revenue from cost-type contracts is recognized as costs are incurred on the basis of direct costs plus allowable indirect costs and an allocable portion of the fixed fee. Revenue from fixed-price type contracts is recognized under the percentage-of-completion method of accounting, with costs and estimated profits included in contract revenue as work is performed. If actual and estimated costs to complete a contract indicate a loss, provision is made currently for the loss anticipated on the contract. Revenue from time and materials contracts is recognized as costs are incurred at amounts represented by the agreed-upon billing amounts. As soon as it is determined that it is probable a contract will result in a loss and the loss can be reasonably estimated, the entire loss is charged to operations.

Revenue recognized on contracts for which billings have not been presented to customers at year end is included in the accounts receivable - contracts classification on the accompanying consolidated balance sheets.

Revenue yet to be recognized on contracts for which billings have been presented to customers is reflected in the accompanying consolidated balance sheets as deferred revenue.

## Bioqual, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

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**Cash and cash equivalents:** Cash and cash equivalents consist of financial instruments with original maturities of less than three months. At times, the Company's cash balances may exceed Federally insured limits. The Company does not believe that this results in any significant risk.

**Government contracts:** A portion of the Company's revenue is from U.S. Government contracts (primarily the National Institutes of Health). The indirect rates used in cost-plus-fixed-fee contracts are subject to final negotiated settlements for each fiscal year. In management's opinion, final settlement of indirect rates will not have a material effect on the Company's financial position or results of operations when settled. The Company does not require collateral for its government billings and does not consider its accounts receivable to be a significant risk.

**Accounts receivable:** The Company provides for an allowance for doubtful accounts based on management's best estimate of possible losses determined principally on the basis of historical experience and specific allowances for known troubled accounts, if needed. All accounts, or portions thereof that are deemed to be uncollectible or that require an excessive collection cost are written off to the allowance for doubtful accounts. At May 31, 2016 and 2015, management deemed all accounts receivable to be collectible.

**Property and equipment:** Property and equipment are recorded at the original cost and are being depreciated on a straight-line basis over estimated lives of three to ten years. Leasehold improvements are amortized over the life of the assets or the remaining period of the lease, whichever is shorter.

## Bioqual, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

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**Goodwill:** Goodwill is tested for impairment on an annual basis, and between annual tests when indicators of impairment exist. Goodwill is written down when impaired. Management has determined that one reporting unit exists for the consolidated group. The Company first assesses qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. If the Company determines that it is more likely than not that the reporting unit's fair value is greater than its carrying amount, then the two step quantitative test is not required. To conduct the qualitative test, the Company identifies the most relevant factors of fair value which they determined to be significant to evaluating goodwill for impairment. These factors include general economic conditions, specific industry conditions and multiples, overall financial performance and operations, and other relevant company specific events.

If the Company determines that the two step quantitative test is required, the first step is to compare the fair value of the reporting unit with its carrying amount. If the fair value of the reporting unit is greater than the carrying amount, then the goodwill is not considered impaired. If the fair value of the reporting unit is less than its carrying value, then goodwill is deemed to be impaired and an impairment loss is calculated.

The Company determined that goodwill was not impaired based on management's consideration of qualitative factors that existed as of May 31, 2016 and 2015. There were no changes to the carrying value of goodwill during the years ended May 31, 2016 and 2015.

**Intangible assets:** Intangible assets consist of customer relationships and an accreditation acquired in the ABL acquisition. Intangible assets and other long-lived assets are reviewed for impairment whenever events or other changes in circumstances indicate that the carrying amount may not be recoverable. In reviewing for impairment, the Company compares the carrying value of the relevant assets to the estimated undiscounted future cash flows expected from the use of the assets and their eventual disposition. When the estimated undiscounted future cash flows are less than their carrying amount, an impairment loss is recognized equal to the difference between the assets' fair value and their carrying value.

At May 31, 2016 and 2015, management determined that there were no indicators of impairment of intangible assets.

## Bioqual, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

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**Income taxes:** Current income tax expense is the amount of income taxes expected to be payable for the current year. Deferred income taxes are recognized for the tax consequences in future years of differences between the tax bases of assets and liabilities and their financial reporting amounts at each year end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable earnings. Valuation allowances are established when necessary to reduce deferred tax assets to the amount more likely than not to be realized.

The Company evaluates uncertainty in income tax positions taken or expected to be taken on a tax return based on a more-likely-than-not recognition standard. If that threshold is met, the tax position is then measured at the largest amount that is greater than 50% likely of being realized upon ultimate settlement and is recognized in the Company's financial statements. To the extent that the Company's estimates change or the final tax outcome of these matters is different than the amounts that have been recorded, such differences will impact the income tax provision when such determinations are made. If applicable, the Company records interest and penalties as a component of income tax expense. As of May 31, 2016 and 2015, there were no accruals for uncertain tax positions. Tax years from May 31, 2013 through the current year remain open for examination by federal and state tax authorities.

**Fair value of financial instruments:** The carrying amounts of obligations approximate their fair value due to the short-term nature or their underlying terms.

**Earnings per share:** The Company calculates basic and diluted earnings per share. Basic earnings per share is calculated using the weighted-average number of common shares outstanding during the period. Diluted earnings per share is calculated using the weighted-average number of common shares plus dilutive potential common shares, if any. There were no dilutive equity securities during the years ended May 31, 2016 and 2015.

**Research and development:** Research and development expenses consist primarily of compensation and related costs for personnel responsible for the research and development of new and existing products and services. The Company expenses research and development costs as incurred. The Company incurred research and development costs of \$277,000 and \$45,000 during the years ended May 31, 2016 and 2015, respectively.

## Bioqual, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

**Long-lived assets and impairment:** The Company periodically evaluates the carrying value of long-lived assets, including, but not limited to, property and equipment and other assets, when events and circumstances warrant such a review. The carrying value of a long-lived asset is considered impaired when the anticipated undiscounted cash flows from such an asset are separately identifiable and are less than its carrying value. In that event, a loss is recognized to the extent that the carrying value exceeds the fair value of the long-lived asset. Fair value is determined primarily using the anticipated cash flows discounted at a rate commensurate with the risk involved.

**Subsequent events:** Management has evaluated subsequent events for disclosure in these consolidated financial statements through September 12, 2016, which is the date the consolidated financial statements are available to be issued.

#### 2. Accounts receivable

Accounts receivable at May 31, 2016 and 2015, consist of amounts due under contracts in progress with Federal government agencies (primarily the National Institutes of Health) educational institutions and commercial companies. The components of accounts receivable are as follows at May 31:

	<u>2016</u>	<u>2015</u>
Billed receivables	\$ 8,349,591	\$ 5,394,662
Unbilled receivables	973,493	2,473,964
<b>Total</b>	<b>\$ 9,323,084</b>	<b>\$ 7,868,626</b>

Four customers generated approximately 57% and 65% of total contract revenues for the years ended May 31, 2016 and 2015, respectively. These customers also comprised approximately 59% and 61% of total receivables as of May 31, 2016 and 2015, respectively.

## Bioqual, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

**3. Intangible assets**

Intangible assets consisted of the following at May 31, 2016 and 2015:

	2016		2015		Weighted Average Life
	Cost	Accumulated Amortization	Cost	Accumulated Amortization	
Customer contracts & relationships	\$ 70,000	\$ (23,049)	\$ 70,000	\$ (12,805)	7
Accreditation	204,000	(204,000)	204,000	(170,000)	2
<b>Total</b>	<b>\$ 274,000</b>	<b>\$ (227,049)</b>	<b>\$ 274,000</b>	<b>\$ (182,805)</b>	-

The definite lived intangible assets have no residual value at the end of their useful lives. Amortization expense for the years ended May 31, 2016 and 2015 was \$44,244 and \$146,244, respectively. Estimated amortization expense for the next five years as of May 31, 2016 is as follows:

Year Ending May 31	Amount
2017	\$ 10,244
2018	10,244
2019	10,244
2020	10,244
2021	5,975

## Bioqual, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

- 4. Note payable - line of credit** - The Company has a line of credit arrangement with a bank which is due on demand. At May 31, 2016 and 2015, the maximum amount available under the arrangement was \$2,000,000. The amount available under the line is the lesser of \$2,000,000, or, the total of 90% of eligible government receivables, plus 80% of eligible commercial receivables less the amount outstanding for letters of credit. There was no balance outstanding on the line at May 31, 2016 or 2015. The line bears interest at the bank's prime rate plus .25% (3.75% at May 31, 2016) and is collateralized by all assets of the Company. The line of credit contains various financial covenants which include maintaining certain ratios of fixed charge coverage, a maximum funded debt to EBITDA, and a maximum debt to tangible net worth. The Company was in compliance with the financial covenants as of May 31, 2016 and 2015.

The Company had an irrevocable standby letter of credit arrangement outstanding with a bank as collateral for a lease at May 31, 2016 and 2015 for an amount of \$203,400.

- 5. Note payable** The Company had the following note payable outstanding at May 31:

	2016	2015
Note payable to a financial institution related to the acquisition of ABL, payable in monthly installments of principal and interest of \$28,087, with interest at 4.62%, final payment February 2019.	\$ 870,056	\$ 1,158,835
Less: Current portion	(302,726)	(288,779)
<b>Long-term portion</b>	<b>\$ 567,330</b>	<b>\$ 870,056</b>

The following is a schedule of future principal maturities of long-term debt at May 31, 2016:

Year Ending May 31	Amount
2017	\$ 302,726
2018	317,214
2019	250,116
<b>Total</b>	<b>\$ 870,056</b>

## Bioqual, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

- 6. Income taxes** For the years ended May 31, 2016 and 2015, the components of the provision for income taxes consisted of:

	<u>2016</u>	<u>2015</u>
Current tax expense	\$ 1,834,719	\$ 929,194
Deferred tax (benefit) expense	(50,057)	283,600
<b>Provision for income taxes</b>	<b>\$ 1,784,662</b>	<b>\$ 1,212,794</b>

The provision for income taxes for the years ended May 31, 2016 and 2015 reflected in the accompanying consolidated statements of income varies from the amount which would have been computed using statutory rates as follows:

	<u>2016</u>	<u>2015</u>
Federal taxes at statutory rate	\$ 1,585,430	\$ 1,060,535
State taxes at statutory rate, net of federal tax benefit	253,902	169,842
Permanent differences and other	(54,670)	(17,583)
<b>Provision for income taxes</b>	<b>\$ 1,784,662</b>	<b>\$ 1,212,794</b>

## Bioqual, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

The deferred income tax asset (liability) represents an estimate of the income tax that will be recoverable in future periods from the cumulative temporary differences recognized for financial reporting purposes from that recognized for income tax reporting purposes. At May 31, 2016 and 2015, the components of these temporary differences and the deferred tax asset (liability) were as follows:

	2016	2015
Accrued vacation	\$ 85,000	\$ 69,200
Accrued expenses	5,800	-
Capitalized costs	46,400	46,400
Depreciation and amortization	8,400	90,800
Deferred rent	145,500	139,300
Contingent consideration	(201,800)	(97,100)
Accounts receivable	(55,043)	(264,400)
<b>Total deferred income benefit (taxes)</b>	<b>\$ 34,257</b>	<b>\$ (15,800)</b>
Current deferred income tax asset (liability)	\$ 35,800	\$ (195,200)
Long-term deferred income tax (liability) asset	(1,543)	179,400
<b>Deferred tax asset (liability)</b>	<b>\$ 34,257</b>	<b>\$ (15,800)</b>

#### 7. Operating leases

The Company is obligated, as lessee, under non-cancelable operating leases covering its facilities and certain equipment expiring at various dates through 2026. One of the three facility leases provides an option to renew for five years. Another facility lease provides for two successive five-year renewal options. Some of the leases provide for annual increases. A deferred rent liability is recorded for the difference between the pro-rata expense recognized and the total amounts paid to date under the leases.

## Bioqual, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

The following is a schedule by years of future minimum rental payments required under the operating leases that have an initial or remaining non-cancelable lease term in excess of one year as of May 31, 2016:

Year Ending May 31	Total
2017	\$ 2,949,958
2018	3,036,881
2019	3,118,712
2020	1,859,039
2021	1,866,041
Thereafter	5,980,246
<b>Total</b>	<b>\$ 18,810,877</b>

Total rent expense for the years ended May 31, 2016 and 2015 was approximately \$2,978,000 and \$2,866,000 respectively.

- 8. Contract status** **Provisional indirect cost rates:** Billings under cost-based government contracts are calculated using provisional rates which permit recovery of indirect costs. These rates are subject to audit on an annual basis by the government agencies' cognizant audit agency. The cost audits will result in the negotiation and determination of the final indirect cost rates which the Company may use for the years audited. The final rates, if different from the provisional rates, may create a receivable or a liability.

As of May 31, 2016, the Company had negotiated final settlements on indirect cost rates through 2011. The Company periodically reviews its cost estimates and experience rates, and adjustments, if needed, are made and reflected in the period in which the estimates are revised. In the opinion of management, redetermination of any cost-based contracts for the open years will not have any material effect on the Company's financial position or results of operations.

The Company has authorized but uncompleted contracts in progress at May 31, 2016, approximately as follows:

Total contract price of initial contract awards including modifications, exercised options, and approved change orders	\$ 31,931,000
Completed to date	(20,345,000)
<b>Authorized backlog</b>	<b>\$ 11,586,000</b>

## Bioqual, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

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The foregoing contracts contain unexercised options and unfunded amounts not reflected in the above amounts totaling approximately \$4,903,000 at May 31, 2016.

- 9. Retirement plan** The Company sponsors a tax deferred savings plan to provide retirement benefits for all eligible employees under the Internal Revenue Code (Code). The Company's annual contribution to the plan is based on eligible employee participation. Participating employees may voluntarily contribute a percentage of their annual salaries, not to exceed certain limits provided by the Code. The Company may make discretionary matches of each participant's contribution. Rights to benefits provided by the Company's contributions vest 20% each year after the second year of service. Participants are fully vested in their voluntary contributions. The Company's contributions for the years ended May 31, 2016 and 2015, were \$91,453 and \$97,524, respectively.
- 10. Commitments and contingencies** The Company has employment agreements with its President and CFO, which provide for a base compensation and additional incentive compensation dependent upon annual operations. The agreements are effective through May 31, 2018 at which time the agreement will automatically renew annually unless either party provides a 30 day notice. If there is a change in control, the agreements shall remain in effect for an additional two years.
- 11. Industry condition** The Federal government is implementing significant changes and reductions to government spending and other programs. The funding of U.S. government programs is subject to an annual Congressional budget authorization and appropriation process. The Company cannot predict the impact on existing, follow-on or replacement programs from potential changes in priorities due to changes in spending levels.



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

Board of Directors  
**Bioqual, Inc. and Subsidiary**  
Rockville, Maryland

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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 consolidated financial statements of **Bioqual, Inc. and Subsidiary**, which comprise the Consolidated Balance Sheet as of May 31, 2016, and the related Consolidated Statements of Income, Stockholders’ Equity and Cash Flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated September 12, 2016.

***Internal Control over Financial Reporting***

In planning and performing our audit of the consolidated financial statements, we considered **Bioqual, Inc. and Subsidiary’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 consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of **Bioqual, Inc. and Subsidiary’s** internal control. Accordingly, we do not express an opinion on the effectiveness of **Bioqual, Inc. and Subsidiary’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 a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s consolidated 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.

**Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards* (continued)**

***Compliance and Other Matters***

As part of obtaining reasonable assurance about whether **Bioqual, Inc. and Subsidiary's** consolidated financial statements are free from material misstatement, we performed tests of their 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*.

***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 the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Aronson LLC*

Rockville, Maryland  
September 12, 2016



## Independent Auditor's Report on Compliance for Each Major Program and on Internal Control over Compliance Required by the Uniform Guidance

Board of Directors  
**Bioqual, Inc. and Subsidiary**  
Rockville, Maryland

### *Report on Compliance for Each Major Federal Program*

We have audited **Bioqual, Inc. and Subsidiary's** compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of **Bioqual, Inc. and Subsidiary's** major federal programs for the year ended May 31, 2016. **Bioqual, Inc. and Subsidiary's** major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs.

### *Management's Responsibility*

Management is responsible for compliance with the requirements of federal statutes, regulations, and the terms and conditions of their federal awards applicable to their federal programs.

### *Auditor's Responsibility*

Our responsibility is to express an opinion on compliance for each of **Bioqual, Inc. and Subsidiary's** major federal programs based on our audit of the types of compliance requirements referred to above. 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 the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance 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 **Bioqual, Inc. and Subsidiary'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 on compliance for each major federal program. However, our audit does not provide a legal determination of **Bioqual, Inc. and Subsidiary's** compliance.

## **Independent Auditor’s Report on Compliance for Each Major Program and on Internal Control over Compliance Required by the Uniform Guidance (continued)**

### ***Opinion on Each Major Federal Program***

In our opinion, **Bioqual, Inc. and Subsidiary** complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended May 31, 2016.

### ***Report on Internal Control over Compliance***

Management of **Bioqual, Inc. and Subsidiary** is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered **Bioqual, Inc. and Subsidiary’s** internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of **Bioqual, Inc. and Subsidiary’s** internal control over compliance.

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

**Independent Auditor's Report on Compliance for Each Major Program and on Internal Control over Compliance Required by the Uniform Guidance (continued)**

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

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

*Aronson LLC*

Rockville, Maryland  
September 12, 2016

# Bioqual, Inc. and Subsidiary

## Schedule of Expenditures of Federal Awards

*Year Ended May 31, 2016*

Federal Grantor/Pass Through Grantor/Program Title	CFDA Number	Contract/Grant/ Subaward Number	Federal Expenditures
<b>Research and Development Cluster</b>			
<b>Department of Health and Human Services</b>			
<b>National Institutes of Health</b>			
Mental Health Research Grant			
Pass Through: Temple University	93.242	360962-04400-02	\$ 151,499
Pass Through: Temple University	93.242	390463-04400-7343-02	95,708
Pass Through: University of Miami	93.242	MR70197	2,448
Allergy, Immunology and Transplantation Research			
Pass Through: University of Hawaii	93.855	KA160010	92,034
Pass Through: University of Illinois	93.855	2014-06427-01-01	372,970
Pass Through: University of Miami	93.855	MR178130	27,205
National Institute of Allergy and Infectious Diseases			
Simian Vaccine Evaluation Unit	93.XXX	HHSN272201300003I	1,647,256
Cotton Rat Model for Evaluation of RSV		HHSN272201000006I	
Vaccines and Therapeutics	93.XXX	A82	535,585
Filovirus Vaccination Studies in Nonhuman Primates	93.XXX	HHSN272201000006I C25	11,457
Filovirus Vaccination Studies in Nonhuman Primates	93.XXX	HHSN272201000006I C29	1,037,527
Nonhuman Primate Model for Filovirus Vaccine & Efficacy Testing	93.XXX	HHSN272201000006I C14	1,600
Animal Models of Infectious Diseases			
Product Safety and Efficacy Assessment of Chlamydia Tracomatis, Trichomonas Vaginalis Mycoplasma Genital Infection	93.XXX	HHSN272201000006I C27	527,936
Model Refinement in Pig-Tailed Macaques:			
Assessments of <i>Chlamydia tracomatis</i> (CT) Infection with Clinical or Laboratory Strains of the Genital Serovars for Product Testing in the Model	93.XXX	HHSN272201000006I C32	911,878
Simian Vaccine Evaluation Unit	93.XXX	HHSN266200600007C	132,547
<b>Total National Institutes of Health</b>			<b>5,547,650</b>
<b>Total Research and Development Cluster / Total Expenditures of Federal Awards</b>			<b>\$ 5,547,650</b>

See accompanying Notes to Schedule of Expenditures of Federal Awards.

# Bioqual, Inc. and Subsidiary

## Notes to Schedule of Expenditures of Federal Awards

**1. Basis of presentation** The accompanying Schedule of Expenditures of Federal Awards (the “Schedule”) includes the federal grant activity and other cost-based and fixed-fee contracts of Bioqual, Inc. and Subsidiary under programs of the federal government for the year ended May 31, 2016. The information in this Schedule is presented in accordance with the requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Because the Schedule presents only a selected portion of the operations of Bioqual, Inc. and Subsidiary, it is not intended to and does not present the consolidated financial position, results of operations, or cash flows of Bioqual, Inc. and Subsidiary.

**2. Summary of significant accounting policies** Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

Bioqual, Inc. and Subsidiary did not elect to use the ten-percent de minimis indirect cost rate.

Pass-through entity identifying numbers are presented where available.

**3. Total federal funds** A reconciliation of the Schedule to the Consolidated Statement of Income for the year ended May 31, 2016 is as follows:

Cost reimbursable federal awards	\$ 5,547,650
Fixed price federal awards and other contracts	27,512,691
<b>Total federal awards and contracts</b>	<b>\$ 33,060,341</b>

**Bioqual, Inc. and Subsidiary**

**Schedule of Findings and Questioned Costs**

*Year Ended May 31, 2016*

**SECTION I - SUMMARY OF AUDITOR'S RESULTS**

**Financial Statements**

Type of auditor's report issued: Unmodified

Internal control over financial reporting:

- Material weakness identified?                           Yes              X              No
- Significant deficiency identified?                       Yes              X              None reported

Noncompliance material to financial statements noted?                   Yes              X              No

**Federal Awards**

Internal control over major programs:

- Material weakness identified?                           Yes              X              No
- Significant deficiency identified?                       Yes              X              None reported

Type of auditor's report issued on compliance for major programs: Unmodified

Any audit findings disclosed that are required to be reported  
in accordance with 2CFR 200.516 (a)?                   Yes              X              No

**Identification of Major Programs:**

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Cluster</u>
93.242, 93.855, 93.XXX	Research and Development Cluster

Dollar threshold used to distinguish between type A and type  
B programs:    \$        750,000

Auditee qualified as low-risk auditee?                   Yes              X              No

**Bioqual, Inc. and Subsidiary**

**Schedule of Findings and Questioned Costs (continued)**

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*Year Ended May 31, 2016*

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**SECTION II - FINANCIAL STATEMENT FINDINGS**

None

**SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

None

**SECTION IV – PRIOR YEAR FINANCIAL STATEMENT FINDINGS**

**Finding 2015-001: Significant Deficiency – Cut-off Procedures**

Condition: Bioqual, Inc. and Subsidiary did not properly accrue certain costs as payable as of year end, so adjustments were required in order to properly state accounts in accordance with GAAP.

Auditor's recommendation: We recommended that the Company review subsequent disbursements and invoices received subsequent to year end for items that should be accrued as payable at year end.

Current status : No similar findings were noted in the 2016 audit.

## Bioqual, Inc. and Subsidiary

### Schedule of Findings and Questioned Costs (continued)

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*Year Ended May 31, 2016*

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#### SECTION V – PRIOR YEAR FEDERAL AWARD FINDINGS AND FOLLOW UP

**Finding number:** 2015-002

**Federal agency:** Department of Health and Human Services

**CFDA #:** 93.XXX

**Office:** National Institutes of Health

**Program:** Animal Models of Infectious Diseases Product Safety and Efficacy Assessment of Chlamydia Tracomatis, Trichomonas Vaginalis Mycoplasma Genital Infection

**Compliance Requirement:** Reporting

**Type of Finding:** Noncompliance and Deficiency in Internal Controls

Condition: The Company did not file a FFATA report for its first tier subaward. The subcontract given in 2015 under the University of Washington cooperative agreement that obligated over \$25,000 in federal funds was not appropriately reported in accordance with FFATA as implemented in 2 CFR part 170.

Auditor's recommendation: The Company should develop risk assessment procedures to identify critical required reporting requirements under their grants and cooperative agreements.

Current status: No similar findings were noted in the 2016 audit.