Kestrel Institute and Subsidiary

Report on Audit of Consolidated Financial Statements

December 31, 2024

(with summarized financial information for 2023)

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KESTREL INSTITUTE AND SUBSIDIARY

TABLE OF CONTENTS

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Kestrel Institute
Palo Alto, California

Report on the Audit of the Consolidated Financial Statements

Opinion

We have audited the financial consolidated statements of Kestrel Institute (a non-profit organization) and subsidiary (collectively, "Kestrel"), which comprise the consolidated statement of financial position as of December 31, 2024, and the related consolidated statements of activities and changes in net assets, functional expenses and cash flows for the year then ended, and the related notes to the consolidated financial statements.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of Kestrel as of December 31, 2024, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP').

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America ("U.S. GAAS") and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are required to be independent of Kestrel and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with U.S. GAAP, and for 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.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about Kestrel's ability to continue as a going concern for one year after the date that the consolidated financial statements are issued.

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and, therefore, is not a guarantee that an audit conducted in accordance with U.S. GAAS and *Government Auditing Standards* will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with U.S. GAAS and *Government Auditing Standards*, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements.
- Obtain an understanding of internal control relevant to the audit 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 Kestrel's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about Kestrel's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying schedule of federal expenditures of federal awards, as required by Title 2 U.S. Code of Federal Regulations 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 U.S. GAAS. 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 26, 2025, on our consideration of Kestrel's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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 Kestrel's internal control over financial reporting and compliance.

Report of Summarized Comparative Information

We have previously audited Kestrel's 2023 consolidated financial statements, and we expressed an unmodified audit opinion on those audited consolidated financial statements in our report dated September 18, 2024. In our opinion, the summarized comparative information presented herein as of and for the year ended December 31, 2023, is consistent, in all material respects, with the audited consolidated financial statements from which it has been derived.

BPM LLP

San Jose, California
September 26, 2025

Kestrel Institute and Subsidiary

Consolidated Statement of Financial Position

As of December 31, 2024

(with summarized comparative totals for 2023)

	2024	2023
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,506,609	$ 1,993,369
Certificates of deposit	1,666,259	1,639,499
Accounts receivable	504,966	565,500
Prepaid expenses and other current assets	96,902	78,039
Total current assets	4,774,736	4,276,407
Unbilled accounts receivable, long-term	33,363	41,251
Other assets	3,000	3,000
Property and equipment, at cost:		
Furniture and equipment	324,420	318,084
Leasehold improvements	94,864	94,864
Accumulated depreciation	(404,091)	(402,057)
Total property and equipment	15,193	10,891
Total assets	$ 4,826,292	$ 4,331,549
LIABILITIES AND NET ASSETS		
Liabilities:		
Accounts payable	$ 41,504	$ 93,269
Accrued payroll and related expenses	480,960	467,543
Total current liabilities	522,464	560,812
Accrued sabbatical	1,233,815	1,157,712
Total liabilities	1,756,279	1,718,524
Commitments and contingencies (Note 4)		
Net assets:		
Without donor restrictions	3,070,013	2,613,025
Total liabilities and net assets	$ 4,826,292	$ 4,331,549

Kestrel Institute and Subsidiary

Consolidated Statement of Activities and Changes in Net Assets

For the year ended December 31, 2024

(with summarized comparative totals for 2023)

	2024	2023
Revenue:		
Public support:		
Federal grants and contracts	$ 3,731,242	$ 4,393,186
Total revenue	3,731,242	4,393,186
Expenses:		
Program services - scientific research and graduate education	3,136,534	3,754,468
Support services - management and general	311,081	314,182
Total expenses	3,447,615	4,068,650
Change in net assets from operations	283,627	324,536
Other income:		
Investment and interest income	152,909	41,411
Other income	20,452	11,913
Total other income	173,361	53,324
Change in net assets	456,988	377,860
Net assets, beginning of year	2,613,025	2,235,165
Net assets, end of year	$ 3,070,013	$ 2,613,025

KESTREL INSTITUTE AND SUBSIDIARY

CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES

For the year ended December 31, 2024

(with summarized comparative totals for 2023)

	Program Services	Support Services		
	Scientific Research and Graduate Education	Management and General	2024 Total Expenses	2023 Total Expenses
Direct labor	$ 935,874	$ 185,463	$ 1,121,337	$ 1,469,364
Other labor related	463,131	-	463,131	517,448
Fringe benefits	612,819	-	612,819	773,155
Travel	18,874	186	19,060	28,047
Consultant	9,000	-	9,000	86,886
Computer allocation	159,773	50,098	209,871	220,857
Subcontract	807,693	-	807,693	769,829
Other	989	-	989	1,171
Occupancy and related costs	128,381	-	128,381	113,687
Accounting	-	55,811	55,811	53,240
Legal	-	-	-	18,113
Software maintenance	-	14,925	14,925	13,948
Depreciation	-	2,034	2,034	1,350
Fees, filings and taxes	-	2,564	2,564	1,555
	$ 3,136,534	$ 311,081	$ 3,447,615	$ 4,068,650

Kestrel Institute and Subsidiary

Consolidated Statement of Cash Flows

For the year ended December 31, 2024

(with summarized comparative totals for 2023)

	2024	2023
Cash flows from operating activities:		
Change in net assets	$ 456,988	$ 377,860
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Investment income	(74,394)	(19,499)
Depreciation	2,034	1,350
Decrease (increase) in operating assets:		
Accounts receivable	68,422	273,748
Prepaid expenses and other current assets	(18,863)	(3,309)
Increase (decrease) in operating liabilities:		
Accounts payable	(51,765)	(141,033)
Accrued payroll and related expenses	13,417	(19,354)
Accrued sabbatical	76,103	116,618
Net cash provided by operating activities	471,942	586,381
Cash flows from investing activities:		
Purchase of property and equipment	(6,336)	(5,687)
Proceeds from sale of investments	516,658	-
Purchases of investments	(469,024)	(1,620,000)
Net cash provided by (used in) investing activities	41,298	(1,625,687)
Net increase (decrease) in cash and cash equivalents	513,240	(1,039,306)
Cash and cash equivalents, beginning of year	1,993,369	3,032,675
Cash and cash equivalents, end of year	$ 2,506,609	$ 1,993,369

1. Description of the Organization

Kestrel Institute ("Kestrel" or the "Institute") was incorporated on January 21, 1981, and formally began operation in October 1981. The primary purpose of the Institute is to provide scientific research and graduate education within the area of computer science.

Kestrel Development Corporation ("KDC"), a wholly-owned for profit subsidiary of the Institute, was incorporated on January 16, 1986. KDC's primary purpose had been the development of the Institute's basic computer science research into commercial applications. KDC is currently inactive.

Scientific Research and Graduate Education Program

The Institute performs research on methods and tools for software assurance, using mathematical models and properties of algorithms and data structures to ensure that software performs predictably and reliably. The Institute communicates to a wide range of academic communities through journals, conferences and technical meetings. United States ("U.S.") and international universities utilize the Institute's tools. The Institute occasionally hosts students for brief periods to work on projects aligned with its research interests.

2. Summary of Significant Accounting Policies

Principles of Consolidation and Basis of Accounting

The consolidated financial statements include those of the Institute (a non-profit organization) and its wholly-owned subsidiary, KDC (a for profit organization). All significant intercompany accounts and transactions have been eliminated in the consolidated financial statements. The consolidated financial statements have been prepared on the accrual basis of accounting.

Basis of Presentation

Net assets are classified based on the existence or absence of donor imposed restrictions. Accordingly, the Institute classified its net assets and changes in net assets as follows:

Net Assets Without Donor Restrictions – Net assets that are not subject to donor-imposed restrictions and may be expended for any purpose in performing the primary objectives of the Institute.

Net Assets With Donor Restrictions – Net assets subject to stipulations imposed by donors and grantors. Some donor restrictions are temporary in nature; those restrictions will be met by actions of the Institute or by passage of time. Other donor restrictions may be perpetual in nature, whereby the donor has stipulated the funds be maintained in perpetuity. Donor-imposed restrictions are released when a restriction expires, that is, when the stipulated time has elapsed, when the stipulated purpose for which the resource was restricted has been fulfilled, or both. The Institute does not have any net assets with donor restrictions as of December 31, 2024.

Cash and Cash Equivalents

For purposes of the accompanying consolidated financial statements, the Institute considers all highly liquid investments purchased with a maturity of three months or less to be cash equivalents.

2. Summary of Significant Accounting Policies, continued

Accounts Receivable and Provision for Credit Losses

Accounts receivable are recognized after costs have been incurred and allowed under the terms of the contract. No provision for credit losses is made for receivables from the federal government, and management provides for a provision for credit losses for receivables from prime contractors when accounts are doubtful of collection. As of December 31, 2024, management believes all account receivables are collectible. Unbilled accounts receivable is an asset account on the consolidated statement of financial position that represents amounts recognized as revenue for which invoices have not yet been sent. This can occur when the Institute invoices in arrears or has any delay in billing relative to approval of billing rates.

Property and Equipment

Property and equipment acquisitions are capitalized when the cost exceeds $5,000, and the assets have a useful life of more than one year. Property and equipment are stated at cost less an allowance for depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets.

Revenue Recognition

Revenue from federal grants and contracts is recognized based on:

- Identifying the contract with a customer;
- Identifying the performance obligations in the contract;
- Determining the transaction price;
- Allocating the transaction price to the performance obligations in the contract; and
- Recognizing revenue when, or as, the performance obligations are satisfied.

The Institute performs the majority of its services under contracts and grants awarded by the U.S. Government. It also performs intraorganizational services for KDC, at actual cost.

The aforementioned revenue streams, which are considered single performance obligations, are recognized as the customers receive title of the intellectual property and research, generally upon delivery (for example, in amounts equal to allowable direct and indirect costs incurred and, where appropriate, fixed fee, up to the limits specified in each agreement). The Institute has elected to use the practical expedient to disregard the financing component when its payment terms are less than one year. The Institute has not incurred any material costs to obtain contracts to date. As of December 31, 2024, the Institute did not have deferred revenue related to the aforementioned contracts.

Contributions

Contribution revenue is recognized when contributions are received. All contributions are considered available for general operations unless specifically restricted by the donor.

2. Summary of Significant Accounting Policies, continued

Contributions, continued

The Institute reports contributions as net assets with donor restrictions support if such contributions are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or a purpose restriction is accomplished, net assets with donor restrictions are reclassified to net assets without donor restrictions and reported as net assets released from restrictions. There were no contributions received or made by the Institute for the year ended December 31, 2024.

Grant and Contract Costs

The Institute's costs under grants and contracts from agencies of the U.S. Government are subject to audit. Audits through 2020 have been completed or waived and the final indirect cost rates have been established through 2024.

Income Taxes

The Institute is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended, and Section 23701 (d) of the California Revenue and Taxation Code. To date, there have been no Internal Revenue Service ("IRS") audits performed on the Institute's annual information returns.

KDC records revenue and expenses using the accrual basis for financial statement and income tax purposes. KDC did not incur either federal or California franchise tax expense during the year ended December 31, 2024. The California tax liability is attributable to interest and limited liability company distributable income as well as the minimum state tax.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements, and the reported amounts of support, revenue and expenses during the reporting period. Accordingly, actual results could differ from those estimates. The Institute's significant estimates include the expected useful lives of property and equipment, and the determination of allowable expense allocations.

Functional Expense Allocation

Directly identifiable expenses are charged to program services and support services. Certain categories of expenses are attributable to more than one program or supporting function and are allocated on a reasonable basis that is consistently applied. The expenses that are allocated are direct labor, which is allocated on the basis of recorded time and effort, and computer allocation, which is allocated based on direct labor. Management and general expenses include those expenses that are not directly identifiable with any other specific function, but provide for the overall support and direction of the Institute. The Institute received funding from established funding sources and no fundraising expenses were incurred. Unallowable costs on the consolidated statement of functional expenses represent miscellaneous and rent expense, which are not allowed to be charged against the research and development federal grants.

2. Summary of Significant Accounting Policies, continued

Risk and Uncertainties

The Institute's business could be impacted by continuing price pressures on new and renewal business, the Institute's ability to effectively control costs, additional competitors entering the Institute's markets and reduced federal spending. Changes in these areas could adversely impact the Institute's operations in the future.

Concentration of Credit Risk

Credit risk represents the accounting loss that would occur if the counterparties to financial instruments in which the Institute was invested failed to perform as contracted. The principal financial instruments which expose the Institute to credit risks are cash equivalents, certificates of deposit, and accounts receivable. The Institute keeps its cash and cash equivalents in major financial institutions in the U.S. At times, balances in U.S. accounts may exceed Federal Deposit Insurance Corporation limits. Management believes that the likelihood of incurring material losses from concentration of credit risk is remote.

Major Customers

Approximately 92% of the Institute's revenue for the year ended December 31, 2024 was derived from contracts and grants for research and development with the U.S. Government. Notably, a single project accounted for 79% of the revenue.

Liquidity and Availability

The Institute regularly monitors liquidity required to meet its operating needs and other contractual commitments, while also striving to maximize the investment of its available funds. The Institute has various sources of liquidity at its disposal, including cash and cash equivalents, and accounts receivable.

For purposes of analyzing resources available to meet general expenditures over a 12-month period, the Institute considers all expenditures related to its ongoing activities, as well as the conduct of services undertaken to support those activities, to be general expenditures. Unbilled accounts receivable are not included in the analysis, as these amounts are not available to meet current operating needs.

In addition to financial assets available to meet general expenditures over the next 12 months, the Institute operates with a balanced budget and anticipates collecting sufficient revenue to cover general expenditures. Refer to the consolidated statement of cash flows, which identifies the sources and uses of the Institute's cash for the year ended December 31, 2024.

The Institute's financial assets available for general expenditures within one year of the consolidated statement of financial position date are as follows:

Financial assets as of December 31, 2024:	
Cash and cash equivalents	$ 2,506,609
Certificates of deposit	1,666,259
Accounts receivable	504,966
	$ 4,677,834

2. Summary of Significant Accounting Policies, continued

Liquidity and Availability, continued

The accompanying consolidated financial statements have been prepared in accordance with U.S. GAAP. For the year ended December 31, 2024, the Institute had a positive change in net assets of approximately $457,000 and had positive cash flow from operations of approximately $472,000. Management is continuously developing strategies to increase revenue, reduce expenses and improve cash flows. The ability to strengthen the Institute's liquidity will depend upon successful implementation of management's plans.

Fair Value Measurement

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., the exit price) in an orderly transaction between market participants at the measurement date. In determining fair value, the Institute uses various valuation approaches. A hierarchy has been established for inputs used in measuring fair value that maximize the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the Institute. Unobservable inputs are inputs that reflect the Institute's assumptions about what market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

The hierarchy is broken down into three levels based on the observability of inputs as follows:

Level 1 - quote prices in active markets for identical investments. Investments in Level 1 include money market funds.

Level 2 - pricing inputs, including broker quotes, are those other than exchange quoted prices in active markets, or are directly or indirectly observable as of the reporting date which the fair value for the investment is determined through the use of models or other valuation methodologies.

Level 3 - pricing inputs are unobservable for the investment and include situations where there is little, if any, market activity for the investments and may require a high level of judgment to determine the fair value.

The categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

As of December 31, 2024, the Institute's fair value hierarchy for its financial assets was as follows:

	Assets at Fair Value as of December 31, 2024			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents:				
Money market funds	$ 1,632,542	$ -	$ -	$ 1,632,542
Investments:				
Certificate of deposit	-	1,666,259	-	1,666,259
	$ 1,632,542	$ 1,666,259	$ -	$ 3,298,801

The Institute did not have any Level 3 assets or liabilities.

3. Property and Equipment and Depreciation Expense

Property and equipment, net, depreciation expense and accumulated depreciation for the year ended December 31, 2024 were as follows:

	Depreciation Method	Estimated Useful Lives	Ending Asset Balance	Depreciation Expense	Accumulated Depreciation
Furniture and equipment	Straight-line	3-5 years	$ 324,420	$ 1,666	$ 314,444
Leasehold improvements	Straight-line	39 years	94,864	368	89,647
			$ 419,284	$ 2,034	$ 404,091

4. Commitments and Contingencies

In December 2023, the Institute signed a month-to-month lease agreement with Kelly-Gordon Company for basement space with a lease term starting January 1, 2024 that automatically renews on the first of each succeeding month and terminates on December 31, 2024. Either party can terminate sooner with written 30-day notice. The monthly rent amount is $4,600. Rent expense charged to operations was $55,200 for the year ended December 31, 2024. In December 2024, the Institute entered into a new month-to-month lease agreement with Kelly-Gordon Company starting January 1, 2025 that automatically renews on the first of each succeeding month and terminates on December 31, 2025. Either party can terminate sooner with written 45-day notice. The monthly rent amount is $5,100.

5. Defined Contribution Retirement Plan

Kestrel maintains a defined contribution plan qualified under IRS Code Section 401(k) covering substantially all employees. Kestrel's employer matching contribution amount was $26,549 for the year ended December 31, 2024.

6. Related-Party Transactions

KDC has a license agreement with Kestrel Technology LLC ("KT") to further develop and enhance certain software in order to complete the technology transition process. KDC owns a 28.70% interest in KT, of which 15% cannot be diluted, and maintains 49% of the voting rights. The investment is recorded on the equity method. The balance of KT's membership is owned by the officers, employees and other individuals. Additionally, the Institute serves as a passthrough entity for a federal grant originating from KT. For the year ended December 31, 2024, the total federal expenditure for this grant amounted to $48,323.

Interest income is earned by both the Institute and KDC. KDC's passive partnership activity is reflected in other income.

7. Subsequent Events

The Institute's management has evaluated subsequent events and transactions through September 26, 2025, the date which the consolidated financial statements were available to be issued, for potential recognition or disclosure in the consolidated financial statements. Management has determined that there are no subsequent events that require disclosure or recognition in the accompanying consolidated financial statements.

SUPPLEMENTARY INFORMATION

KESTREL INSTITUTE AND SUBSIDIARY

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

For the year ended December 31, 2024

Federal Grantor/Pass-Through Grantor/Program Title	Federal Assistance Listing Number	Passed Through to Subrecipients	Federal Expenditures
Research and Development Cluster:			
U.S. Department of Defense			
U.S. Air Force Contracts			
FA8750-22-C-1530 (CPFF) AFRL Fight Tonight	12.UNKNOWN	$ 807,693	$ 2,943,100
Subaward No. 1160688 (CPFF) BAE Fight Tonight (PRIME BAE FA8750-22-C-1529)	12.UNKNOWN	-	484
Subcontract PO# 4202950235 (CPFF) BBN ARC (Prime contract BBN Technologies FA8750-24-C-B031)	12.UNKNOWN	-	303,762
Subcontract PO# 4203051318 (CPFF) BBN Fight Tonight Prime contract BBN Technologies FA8750-22-C-1532	12.UNKNOWN	-	149,153
Subaward No. KT0510-2023-KI (Firm Fixed Price) KT HHP2 (PRIME FA8750-23-C-0510)	12.UNKNOWN	-	48,324
Total U.S. Department of Defense		807,693	3,444,823
Total Expenditures of Federal Awards		$ 807,693	$ 3,444,823

1. Basis of Presentation

The accompanying schedule of expenditures of federal awards (the “Schedule”) includes the federal grant activity of Kestrel Institute and Subsidiary (“Kestrel”) under programs of the federal government for the year ended December 31, 2024. The information in the 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) and is based on its claimed costs with voluntary reduction. The Final Claimed Rates submission is based on the audited consolidated financial statements less unallowable costs. Therefore, some amounts presented in this Schedule may differ from amounts presented in, or used in the preparation of, the basic consolidated financial statements. Because the Schedule presents only a selected portion of the operations of Kestrel, it is not intended to and does not present the financial position, change in net assets, or cash flows of Kestrel.

2. Summary of Significant Accounting Policies

Expenditures reported on the Schedule are reported on the accrual basis of accounting, and adjusted for the requirements described in Note 1. 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. Kestrel has elected not to use the 10-percent de minimis indirect cost rate allowed under the Uniform Guidance.

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

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Kestrel Institute
Palo Alto, California

We have audited 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, the consolidated financial statements of Kestrel Institute and Subsidiary (a non-profit organization, "Kestrel"), which comprise the consolidated statement of financial position as of December 31, 2024, and the related consolidated statements of activities and changes in net assets, functional expenses, 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 26, 2025.

Report on Internal Control over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered Kestrel's internal control over financial reporting (internal control) as a basis for designing 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 Kestrel's internal control. Accordingly, we do not express an opinion on the effectiveness of Kestrel'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 Kestrel'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.

Report on Compliance and Other Matters

As part of obtaining reasonable assurance about whether Kestrel's consolidated 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 consolidated financial statements. 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 Kestrel'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 Kestrel's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

BPM LLP

San Jose, California
September 26, 2025

10 Almaden Boulevard, Suite 1000, San Jose, CA 95113
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REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM AND REPORT ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH THE UNIFORM GUIDANCE

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Kestrel Institute
Palo Alto, California

Report on Compliance for Each Major Federal Program

Opinion on Each Major Federal Program

We have audited Kestrel Institute and Subsidiary's (a non-profit organization, "Kestrel") compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of Kestrel's major federal programs for the year ended December 31, 2024. Kestrel's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

In our opinion, Kestrel complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2024.

Basis for Opinion on Each Major Federal Program

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America ("U.S. GAAS"); the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States ("*Government Auditing Standards*"); 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"). Our responsibilities under those standards and the Uniform Guidance are further described in the Auditors' Responsibilities for the Audit of Compliance section of our report.

We are required to be independent of Kestrel and to meet our other ethical responsibilities, in accordance with relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion on compliance for each major federal program. Our audit does not provide a legal determination of Kestrel's compliance with the compliance requirements referred to above.

Responsibilities of Management for Compliance

Management is responsible for compliance with the requirements referred to above and for the design, implementation, and maintenance of effective internal control over compliance with the requirements of laws, statutes, regulations, rules and provisions of contracts or grant agreements applicable to Kestrel's federal programs.

Auditors' Responsibilities for the Audit of Compliance

Our objectives are to obtain reasonable assurance about whether material noncompliance with the compliance requirements referred to above occurred, whether due to fraud or error, and express an opinion on Kestrel's compliance based on our audit. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with U.S. GAAS, *Government Auditing Standards*, and the Uniform Guidance will always detect material noncompliance when it exists. The risk of not detecting material noncompliance resulting from fraud is higher than for that resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Noncompliance with the compliance requirements referred to above is considered material if there is a substantial likelihood that, individually or in the aggregate, it would influence the judgment made by a reasonable user of the report on compliance about Kestrel's compliance with the requirements of each major federal program as a whole.

In performing an audit in accordance with U.S. GAAS, *Government Auditing Standards*, and the Uniform Guidance, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material noncompliance, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding Kestrel's compliance with the compliance requirements referred to above and performing such other procedures as we considered necessary in the circumstances.
- Obtain an understanding of Kestrel's internal control over compliance relevant to the audit in order to design audit procedures that are appropriate in the circumstances 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 Kestrel's internal control over compliance. Accordingly, no such opinion is expressed.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and any significant deficiencies and material weaknesses in internal control over compliance that we identified during the audit.

Report on 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 a 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.

Our consideration of internal control over compliance was for the limited purpose described in the Auditors' Responsibilities for the Audit of Compliance section above and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies in internal control over compliance. Given these limitations, during our audit we did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, material weaknesses or significant deficiencies in internal control over compliance may exist that were not identified.

Our audit was not designed for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, no such opinion is expressed.

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.

BPM LLP

San Jose, California
September 26, 2025

Section I – Summary of Audit Results

Financial Statements

1. Type of auditors' report issued:	Unmodified
2. Internal control over financial reporting	
• Material weakness identified?	No
• Significant deficiencies identified?	None reported
3. Noncompliance material to financial statements noted?	No

Federal Awards

4. Internal control over major programs:	
• Material weakness identified?	No
• Significant deficiencies identified?	None reported
5. Type of auditors' report issued on compliance for major programs:	Unmodified
6. Any audit findings disclosed that are required to be reported in accordance with 2 CFR Section 200.516 (a)?	No
7. Identification of major programs:	

Assistance Listing Number	Funding Agency	Major Program
12.UNKNOWN	Department of Defense	Research and Development Cluster

8. Dollar threshold used to distinguish between type A and type B Programs:	$750,000
9. Auditee qualified as low-risk auditee?	Yes

Section II – Financial Statement Findings

No matters were reported.

Section III – Federal Findings and Questioned Costs

No matters were reported.

Section IV – Status of Prior Year Audit Findings

Not applicable. No prior year findings noted.