

Financial Statements

HUNTINGTON MEDICAL RESEARCH INSTITUTES

For the Year Ended September 30, 2015

CONTENTS

Independent Auditor's Report	1 - 2
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Financial Statements

Statement of Financial Position	3
Statement of Activities and Changes in Net Assets	4 - 5
Statement of Functional Expenses	6
Statement of Cash Flows	7
Notes to Financial Statements	8 - 27

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Huntington Medical Research Institutes

We have audited the accompanying financial statements of Huntington Medical Research Institutes (a nonprofit organization) which comprise the statement of financial position as of September 30, 2015, and the related statements of activities and changes in net assets, functional expenses, and cash flows for the year 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 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 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 financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

To the Board of Directors
Huntington Medical Research Institutes

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Huntington Medical Research Institutes as of September 30, 2015, 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.

Report on Summarized Comparative Information

We have previously audited Huntington Medical Research Institutes' 2014 financial statements and we expressed an unmodified audit opinion on those audited financial statements dated January 21, 2015. In our opinion, the summarized comparative information presented herein as of and for the year ended September 30, 2014, is consistent, in all material respects, with the audited financial statements from which it has been derived.

A handwritten signature in black ink that reads "Martin Werbelow LLP". The signature is written in a cursive, flowing style.

March 16, 2016

HUNTINGTON MEDICAL RESEARCH INSTITUTES
STATEMENT OF FINANCIAL POSITION
SEPTEMBER 30, 2015
With Comparative Totals for 2014

ASSETS

	<u>2015</u>	<u>2014</u>
Assets		
Cash and cash equivalents	\$ 693,724	\$ 1,595,380
Government and other contract receivables	192,057	1,633,391
Other receivables	52,892	98,256
Unconditional promises to give	1,551,995	1,048,737
Prepaid expenses	69,808	117,336
Cash designated for capital expenditures	5,430,488	5,587,057
Investments	40,527,984	42,530,414
Land, buildings, and equipment, net	10,369,701	8,706,079
Beneficial interest in a charitable remainder unitrust	119,304	131,643
Patents, net	162,436	214,336
Patent deposits	221,863	282,338
Total Assets	<u>\$ 59,392,252</u>	<u>\$ 61,944,967</u>

LIABILITIES AND NET ASSETS

Liabilities		
Accounts payable	\$ 548,243	\$ 356,700
Accrued expenses and deposits	182,235	327,491
Deferred revenue	506,817	455,394
Accrued pension cost	5,132,640	3,763,301
Total Liabilities	<u>6,369,935</u>	<u>4,902,886</u>
Net Assets		
Unrestricted net assets		
Undesignated	3,477,042	3,135,048
Designated by the Board	29,506,336	32,795,448
Total Unrestricted Net Assets	32,983,378	35,930,496
Temporarily restricted net assets	14,552,147	17,624,793
Permanently restricted net assets	5,486,792	3,486,792
Total Net Assets	<u>53,022,317</u>	<u>57,042,081</u>
Total Liabilities and Net Assets	<u>\$ 59,392,252</u>	<u>\$ 61,944,967</u>

The accompanying notes are an integral part of these statements.

HUNTINGTON MEDICAL RESEARCH INSTITUTES
STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED SEPTEMBER 30, 2015
With Comparative Totals for 2014

	2015			2014	
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
Support, Revenue, Gains, and Investment Return					
Specific research:					
Government funded grants and contracts	\$ 2,034,853	\$ -	\$ -	\$ 2,034,853	\$ 2,563,849
Privately funded grants, contracts and projects	638,416	984,272	-	1,622,688	3,629,987
Partnership income	496,231	-	-	496,231	146,252
Donations	486,900	1,476,526	-	1,963,426	636,791
Bequests	127,922	-	2,000,000	2,127,922	118,797
Rental income	300,950	-	-	300,950	260,947
Loss in value - charitable remainder unitrust	-	(11,834)	-	(11,834)	(7,203)
Clinical and royalty income	633,563	-	-	633,563	839,216
Total Support and Revenue	<u>4,718,835</u>	<u>2,448,964</u>	<u>2,000,000</u>	<u>9,167,799</u>	<u>8,188,636</u>
Other Gains and Losses					
Special Events					
Special events contributions	-	-	-	-	138,323
Special events revenue	-	-	-	-	82,125
Special events expense	-	-	-	-	(141,404)
Net Special Events	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>79,044</u>
Net Assets Released Due to Satisfaction of Restrictions	<u>5,174,801</u>	<u>(5,174,801)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Investment Return Designated for Current Operations	<u>2,710,362</u>	<u>-</u>	<u>-</u>	<u>2,710,362</u>	<u>2,520,989</u>
Total Support, Revenue, Gains, and Investment Return	<u>12,603,998</u>	<u>(2,725,837)</u>	<u>2,000,000</u>	<u>11,878,161</u>	<u>10,788,669</u>
Expenses					
Research	7,213,340	-	-	7,213,340	6,294,426
Research support services:					
General	1,521,894	-	-	1,521,894	1,279,888
Fundraising	1,088,925	-	-	1,088,925	588,625
Total Research Support Services	<u>2,610,819</u>	<u>-</u>	<u>-</u>	<u>2,610,819</u>	<u>1,868,513</u>
Total Expenses	<u>9,824,159</u>	<u>-</u>	<u>-</u>	<u>9,824,159</u>	<u>8,162,939</u>
Change in Net Assets from Operations	<u>2,779,839</u>	<u>(2,725,837)</u>	<u>2,000,000</u>	<u>2,054,002</u>	<u>2,625,730</u>

The accompanying notes are an integral part of these statements.

HUNTINGTON MEDICAL RESEARCH INSTITUTES
STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED SEPTEMBER 30, 2015
With Comparative Totals for 2014
(continued)

	2015			2014	
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
Net Investment Return					
Interest and dividends	\$ 344,165	\$ 98,719	\$ -	\$ 442,884	\$ 501,802
Realized gains on investments	1,428,728	382,829	-	1,811,557	2,630,014
Unrealized gains (losses) on investments	(3,126,963)	(828,357)	-	(3,955,320)	368,019
Investment fees	(293,186)	-	-	(293,186)	(293,945)
Total Net Investment Return	(1,647,256)	(346,809)	-	(1,994,065)	3,205,890
Less Investment Return Designated for Current Operations	(2,710,362)	-	-	(2,710,362)	(2,520,989)
Investment Return Reduced by the Portion of Cumulative Net Appreciation Designated for Current Operations	(4,357,618)	(346,809)	-	(4,704,427)	684,901
Change in Net Assets Before Pension-related Changes Other Than Net Periodic Pension Cost	(1,577,779)	(3,072,646)	2,000,000	(2,650,425)	3,310,631
Pension-related Changes Other Than Net Periodic Pension Cost	(1,369,339)	-	-	(1,369,339)	1,019,685
Change in Net Assets	(2,947,118)	(3,072,646)	2,000,000	(4,019,764)	4,330,316
Net Assets, Beginning	35,930,496	17,624,793	3,486,792	57,042,081	52,711,765
Net Assets, Ending	<u>\$32,983,378</u>	<u>\$14,552,147</u>	<u>\$ 5,486,792</u>	<u>\$53,022,317</u>	<u>\$57,042,081</u>

The accompanying notes are an integral part of these statements.

HUNTINGTON MEDICAL RESEARCH INSTITUTES
STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED SEPTEMBER 30, 2015
With Comparative Totals for 2014

	2015			2014	
	Research Support Services		Total	Total	
	Research	General			
Salaries and wages	\$ 2,913,582	\$ 702,454	\$ 357,641	\$ 3,973,677	\$ 3,458,839
Payroll taxes and employee benefits	1,195,532	288,238	146,752	1,630,522	1,519,897
Total Personnel Costs	4,109,114	990,692	504,393	5,604,199	4,978,736
Professional fees and contract service payments	420,130	469,765	402,121	1,292,016	867,821
Research and other supplies	525,369	-	67,451	592,820	464,132
Office and other expenses	271,981	220,380	82,691	575,052	489,667
Occupancy and related expenses	389,204	43,860	8,772	441,836	435,788
Repairs, maintenance, and service contracts	389,475	17,903	3,581	410,959	414,875
Impairment loss on patents and patent deposits	186,669	-	-	186,669	-
Insurance	143,927	11,021	2,204	157,152	155,240
Taxes and licenses	113,216	12,865	2,573	128,654	81,260
Travel, conferences, conventions and meetings	29,848	14,601	12,502	56,951	65,585
Total Expenses Before Depreciation and Amortization	6,578,933	1,781,087	1,086,288	9,446,308	7,953,104
Depreciation and amortization	634,407	33,993	2,637	671,037	503,780
Total Expenses	7,213,340	1,815,080	1,088,925	10,117,345	8,456,884
Less Expenses Included with Investment Return in the Statement of Activities and Changes in Net Assets	-	(293,186)	-	(293,186)	(293,945)
Total Expenses Included in the Expenses Section of the Statement of Activities and Changes in Net Assets	<u>\$ 7,213,340</u>	<u>\$ 1,521,894</u>	<u>\$ 1,088,925</u>	<u>\$ 9,824,159</u>	<u>\$ 8,162,939</u>

The accompanying notes are an integral part of these statements.

HUNTINGTON MEDICAL RESEARCH INSTITUTES
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED SEPTEMBER 30, 2015
With Comparative Totals for 2014

	2015	2014
Cash Flows from Operating Activities		
Cash received from service recipients	\$ 3,007,487	\$ 3,836,509
Cash received from donors	3,728,015	2,825,633
Cash received from interest and dividends	436,384	411,817
Cash paid to suppliers and employees	(9,150,824)	(8,005,870)
Net Cash Used in Operating Activities	(1,978,938)	(931,911)
Cash Flows from Investing Activities		
Purchase of land, buildings, and equipment	(2,318,101)	(1,094,362)
Purchase of investments	(8,146,650)	(5,770,155)
Proceeds from sale of investments	8,479,988	7,951,007
Distributions from partnership	21,560	178,360
Deposits paid on patents	(90,852)	(84,788)
Proceeds from restricted cash and cash equivalents	1,224,602	442,050
Purchase of restricted cash and cash equivalents	(1,068,033)	(368,653)
Net Cash Provided by (Used in) Investing Activities	(1,897,486)	1,253,459
Cash Flows from Financing Activities		
Contributions restricted for capital campaign	968,268	368,653
Contributions restricted for permanent endowment	2,000,000	-
Investment income restricted for capital campaign	6,500	89,985
Net Cash Provided by Financing Activities	2,974,768	458,638
Net Increase (Decrease) in Cash and Cash Equivalents	(901,656)	780,186
Cash and Cash Equivalents, Beginning	1,595,380	815,194
Cash and Cash Equivalents, Ending	\$ 693,724	\$ 1,595,380
Reconciliation of Change in Net Assets to Net Cash Used in Operating Activities		
Change in net assets	\$ (4,019,764)	\$ 4,330,316
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation and amortization	671,037	503,780
Investment income restricted for capital expenditures	(6,500)	(89,985)
Net realized and unrealized losses (gains) on investments	2,143,763	(2,998,033)
Loss in value - charitable remainder unitrust	12,339	7,203
Partnership income	(496,231)	(146,252)
Loss on write-down of unconditional promises to give	15,000	-
Impairment loss on patents and patent deposits	186,669	-
Contributions restricted for capital expenditures, net	(235,434)	(89,985)
Contributions restricted for permanent endowment	(2,000,000)	-
Amortization of discount on unconditional promises to give	(11,092)	(39,001)
(Increase) decrease in:		
Government and other contract receivables	1,441,334	(1,421,207)
Other receivables	45,364	(9,243)
Unconditional promises to give	(1,240,000)	(10,000)
Prepaid expenses	47,528	(15,972)
Increase (decrease) in:		
Accounts payable	191,543	231,362
Accrued expenses and deposits	(145,256)	(26,640)
Deferred revenue	51,423	102,947
Accrued pension costs	1,369,339	(1,261,201)
Net Cash Used in Operating Activities	\$ (1,978,938)	\$ (931,911)

The accompanying notes are an integral part of these statements.

**HUNTINGTON MEDICAL RESEARCH INSTITUTES
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2015**

Note 1 – Organization and Summary of Significant Accounting Policies

Organization

Huntington Medical Research Institutes (HMRI) is a nonprofit public benefit California Corporation engaged in a program of basic and applied research devoted to new and advanced studies into the causes, nature, prevention, and cure of human diseases. Funding for research is received from the community and the federal government in the form of donations, contracts, and grants. HMRI is subject to, and undergoes, a Single Audit annually in accordance with the Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, due to its expenditure of \$750,000 or more in federal grant awards.

HMRI conducts medical research in nine different areas, the results of which are published in peer-reviewed papers presented in scientific and medical journals, and displayed at scientific meetings as platform presentations and poster sessions. The nine areas include development of electronic neural implants; development of new magnetic resonance imaging technology; studies of new hepatitis drugs and post-hepatitis cancer detection methods; gene-sequencing studies of cancer; development of new tissue engineering methods; proteomic profiling of cerebrospinal fluid in neurological diseases; research on colorectal cancer; and studies of potential new biomarkers in breast and prostate cancer. HMRI also conducts post-doctoral fellowship training programs and a summer student medical research program.

Basis of Accounting

HMRI accounts for its financial transactions using the accrual basis of accounting. The accrual basis of accounting recognizes revenues in the accounting period in which revenues are earned regardless of when cash is received and recognizes expenses in the accounting period in which expenses are incurred regardless of when cash is disbursed.

Basis of Presentation

HMRI's financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). Under U.S. GAAP, HMRI is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

Comparative Financial Information

The financial statements include certain prior-year summarized comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with U.S. GAAP. Accordingly, such information should be read in conjunction with HMRI's financial statements as of and for the year ended September 30, 2014, from which the summarized information was derived.

Support and Revenue

Unrestricted donations are recognized as income in the year they are received.

Amounts received or promised that are designated for future periods or restricted by the donor for specific purposes are reported as temporarily or permanently restricted support that increases those net asset classes.

HUNTINGTON MEDICAL RESEARCH INSTITUTES
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2015

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Support and Revenue (continued)

When a temporary restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restriction.

Management has evaluated unconditional promises to give and believes that all such unconditional promises are fully collectible based on the history of collections from the donors. Accordingly, no allowance for uncollectible promises to give has been made.

Conditional promises to give are not included as donations until the conditions are substantially met.

Revenues from government agencies are recorded as of the date HMRI has the right to receive such revenue under cost reimbursement contracts currently in force. With most of these contracts, the nonprofit organization incurs expenses while fulfilling the terms of the contract and then requests reimbursement from the government for those expenses. HMRI adheres to the cost reimbursement guidelines as set forth in OMB Circular A-122 *Cost Principles for Non-profit Organizations*. Allowable costs incurred in excess of amounts reimbursed under these contracts are included under government and other contracts receivable in the statement of financial position. One contract permits HMRI to draw down amounts in advance of expenses incurred under the contract. Amounts advanced in excess of these expenditures are recorded as deferred revenue in the accompanying statement of financial position.

Management believes that government and other contracts receivable are fully collectible as of September 30, 2015; accordingly, no allowance for doubtful accounts has been established for these receivables.

Cash and Cash Equivalents

For the purpose of financial statement reporting, HMRI considers all money market accounts and all highly liquid debt investments purchased with original maturity dates of three months or less to be cash equivalents.

Cash Designated for Capital Expenditures

Cash designated for capital expenditures consists of temporarily restricted contributions received as part of HMRI's capital campaign and awaiting expenditure according to the HMRI's facilities' expansion plan (Note 8).

Patents

The legal costs to secure patents are capitalized and amortized using the straight-line method over 20 years.

Patent Deposits

Patent deposits represent accumulated legal and other costs related to registration and development of future patents. Upon approval of the patent, the costs are reclassified as patents and are amortized as described above.

HUNTINGTON MEDICAL RESEARCH INSTITUTES
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2015

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Asset Impairment Estimates

HMRI evaluates the recoverability of identifiable long-term assets whenever events or changes in circumstances indicate that the asset's carrying amount may not be recoverable. Such circumstances could include, but are not limited to: 1) a significant decrease in the market value of the asset; 2) a significant adverse change in the extent or manner in which an asset is used; or 3) an accumulation of costs significantly in excess of the amount originally expected for the acquisition of an asset. HMRI measures the carrying amount of the asset against the estimated undiscounted future cash flows associated with it. Should the sum of the expected future net cash flows be less than the carrying value of the asset being evaluated, an impairment loss would be recognized. The impairment loss would be calculated as the amount by which the carrying value of the asset exceeds its fair value. The fair value is measured based on quoted market prices, if available. If quoted market prices are not available, the estimate of fair value is based on various valuation techniques, including the discounted value of estimated future cash flows. The evaluation of asset impairment requires HMRI to make assumptions about future cash flows over the life of the asset being evaluated. These assumptions require significant judgment and actual results may differ from assumed and estimated amounts. During the year ended September 30, 2015, HMRI recorded an impairment loss of \$186,669 related to patents and patent deposits. HMRI did not record an impairment loss for the year ended September 30, 2014.

Land, Buildings, and Equipment

Land, buildings, and equipment are recorded at cost if purchased and at fair market value if contributed. Depreciation is provided on a straight-line basis over the estimated useful lives of the assets as follows:

Buildings and improvements	3 - 30 years
Lab and other equipment	3 - 10 years

Depreciation on construction in process begins when the related assets are placed in service.

Expenditures for maintenance and repairs are charged to expense; betterments and major renewals are capitalized.

Net Assets

HMRI's net assets comprise the following:

Unrestricted Net Assets

The unrestricted net assets include expendable net assets available to support the general research, administration, and fundraising of HMRI. The unrestricted net assets include Board-designated balances of \$29,506,336 for investment activities.

HUNTINGTON MEDICAL RESEARCH INSTITUTES
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2015

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Net Assets (continued)

Temporarily Restricted Net Assets

Temporarily restricted net assets include assets held in a charitable remainder unitrust and donor-restricted grants, contracts, and projects designated for specific research activities, program expenditures, or equipment acquisitions. Assets donated with explicit restrictions regarding their use and contributions of cash that must be used to acquire property and equipment are reported as restricted contributions. Absent donor stipulations regarding how long those donated assets must be maintained, HMRI reports expirations of donor restrictions when the donated or acquired assets are placed in service, or in the case of buildings and building improvements, when capital expenses are paid. HMRI reclasses temporarily restricted net assets to unrestricted net assets at that time. At September 30, 2015, the temporarily restricted net assets totaled \$14,552,147.

Permanently Restricted Net Assets

The Ross McCollum Endowment Trust was created in 1991 pursuant to the provisions of a trust created under the Will of Ross McCollum. Under the provisions of the trust, the principal of \$3,486,792 is to remain intact and kept separate from the other assets of HMRI. The income from the fund is available for HMRI's unrestricted use.

The Marylou Ingram fund was created in 2015 pursuant to the provisions of a trust that was created by Marylou Ingram in 2006 and restated in 2012 and that became irrevocable in 2013 upon the death of Marylou Ingram. Under the provisions of the trust, the principal of \$2,000,000 is to remain intact and kept separate from other assets of HMRI. The income from the fund is available for research in tissue engineering, cancer molecular genetics, and other related research programs.

Donated Assets

Donations and bequests are recorded as made. All donations are considered to be available for unrestricted use unless specifically restricted by the donor.

Donated securities and other noncash donations are recorded as contributions at their estimated fair values at the date of donation.

Expense Allocations

The costs of providing various programs and other activities have been summarized on a functional basis in the statement of activities. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP 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.

HUNTINGTON MEDICAL RESEARCH INSTITUTES
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2015

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Income Taxes

HMRI qualifies as a nonprofit organization under Section 501(c)(3) of the Internal Revenue Code (IRC). HMRI has been classified as an organization that is not a private foundation as defined in Section 509(a) of the IRC. Further, it has been determined that HMRI is a “publicly supported” organization. Accordingly, contributions by individual donors qualify for the maximum limitation under Section 170(b)(1)(A) of the IRC. Nonprofit organizations are generally not liable for taxes on income; therefore, no provision is made for such taxes in the financial statements.

HMRI considers many factors when evaluating and estimating its tax positions and tax benefits, which may require periodic adjustments and which may not accurately anticipate actual outcomes. HMRI evaluates its uncertain tax positions in accordance with standards set forth under U.S. GAAP. These standards require management to perform an evaluation of all income tax positions taken, or expected to be taken, in the course of preparing HMRI’s tax returns. Management believes the tax positions taken more likely than not will be sustained under examination by the applicable tax authorities. Examples of tax positions taken include the tax-exempt status of HMRI and various positions related to potential sources of unrelated business taxable income. Since matters are subject to some degree of uncertainty, there can be no assurance that HMRI’s tax returns will not be challenged by the tax authorities and that HMRI will not be subject to additional tax, penalties, and interest as a result of such challenge. Generally, HMRI’s tax returns remain open for three years for federal tax examination and four years for state tax examination.

Reclassifications

Certain accounts in the prior-year financial statements have been reclassified for comparative purposes to conform to the presentation in the current-year financial statements

Note 2 – Unconditional Promises to Give

As of September 30, 2015, unconditional promises to give are scheduled to be collected as follows:

Promises scheduled to be collected in one year or less	\$ 739,834
Promises scheduled to be collected in one to five years	641,664
Promises scheduled to be collected in five years or more	<u>245,000</u>
Gross unconditional promises to give	1,626,498
Less discount to present value at 2%	<u>74,503</u>
Unconditional promises to give at present value	<u>\$ 1,551,995</u>

**HUNTINGTON MEDICAL RESEARCH INSTITUTES
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2015**

Note 3 – Conditional Promises to Give

In 2007, HMRI received a conditional promise to give of \$1,000,000. The first payment of \$300,000 was received in 2007, and the second payment of \$100,000 was received in 2008. HMRI also received \$100,000 each during the years ended September 30, 2011 and September 30, 2012 for a total of \$600,000 received as of September 30, 2015. All of those payments were recorded as a donation at the time the donation was received. The remaining balance is receivable in equal amounts of \$100,000 each over the next several years provided that the donor has sufficient funds and the donor's board of directors ratifies the continuance of the pledge at each succeeding annual meeting. These payments will be recorded as donations when the conditions are substantially met.

In 2011, HMRI received a conditional promise to give of \$500,000. The first payment of \$250,000 will be paid when HMRI receives a building permit and begins construction as part of its expansion plan (Note 8). The second payment of \$250,000 will be paid when construction is complete and HMRI receives its certificate for occupancy of the new building. As of September 30, 2015, none of the conditions have substantially been met; therefore, the conditional promise to give was not recorded as a donation.

Also in 2011, HMRI received a conditional promise to give of \$1,000,000. Payments on this conditional promise to give are expected to commence once HMRI completes construction of the building (Note 8). As of September 30, 2015, this condition has not been met; therefore, the conditional promise to give was not recorded as a donation.

Note 4 – Other Receivables

Other receivables consist of the following as of September 30, 2015 and 2014:

	2015	2014
Liver Center Salaries	\$ 30,758	\$ 51,805
Huntington Memorial Hospital Trust	-	19,171
Huntington Outpatient Imaging Center (Note 14)	15,684	18,772
Other miscellaneous receivables	6,450	8,508
	\$ 52,892	\$ 98,256

No provision for doubtful accounts has been made since HMRI anticipates full collection of these amounts.

Note 5 – Investments

Investments in marketable securities are stated at their fair value. Contributed securities are recorded at their fair value at the date of donation.

Security transactions are generally accounted for in the Investment Fund. Dividend and interest income is recorded in the Undesignated Fund. HMRI invests for total return, which may reduce the annual yield. Transfers from the Investment Fund to the Undesignated Fund are allowed to offset such reduced yield.

HUNTINGTON MEDICAL RESEARCH INSTITUTES
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2015

Note 5 – Investments (continued)

HMRI's investment spending policy seeks to preserve and build its Investment Fund. Accordingly, HMRI has established an investment spending policy that generally allows for four percent of the aggregate fair value of its investments to be expendable.

As of September 30, 2015 and 2014, investments consist of the following:

2015	Aggregate Fair Value	Cost
Cash being held for investment	\$ 3,962,910	\$ 3,962,910
Common stock	5,948,858	3,617,418
Mutual funds	14,838,863	13,486,933
Pooled funds	1,723,528	1,381,925
Limited partnership interests	5,933,379	5,040,235
Offshore funds	8,111,818	6,619,143
Life insurance	8,628	8,628
	<u>\$ 40,527,984</u>	<u>\$ 34,117,192</u>

2014	Aggregate Fair Value	Cost
Cash being held for investment	\$ 2,252,777	\$ 2,252,777
Common stock	6,095,289	3,434,342
Mutual funds	17,089,692	13,718,039
Pooled funds	1,483,075	716,984
Limited partnership interests	5,792,593	4,457,043
Offshore funds	9,808,360	7,576,488
Life insurance	8,628	8,628
	<u>\$ 42,530,414</u>	<u>\$ 32,164,301</u>

Investments by net asset class were as follows as of September 30, 2015 and 2014:

	2015	2014
Unrestricted	\$ 30,002,922	\$ 32,990,846
Temporarily restricted	5,038,270	6,052,776
Permanently restricted	5,486,792	3,486,792
	<u>\$ 40,527,984</u>	<u>\$ 42,530,414</u>

HUNTINGTON MEDICAL RESEARCH INSTITUTES
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2015

Note 5 – Investments (continued)

Investments by intended purpose were as follows as of September 30, 2015 and 2014:

	<u>2015</u>	<u>2014</u>
Undesignated	\$ 610,709	\$ 195,398
Capital campaign	420,776	541,461
Endowments	39,496,499	41,793,555
	<u>\$ 40,527,984</u>	<u>\$ 42,530,414</u>

Note 6 – Charitable Remainder Unitrust

During 2003, HMRI became the beneficiary and administrator of a charitable remainder unitrust (CRUT). The CRUT provides the donor income for the donor's lifetime, after which the remaining funds will be distributed to HMRI. These amounts are recorded at present value, which represents the current fair market value of the trust, reduced by the estimated actuarial liability necessary to meet the future payments to the life income beneficiary. The portion of the gift attributable to the present value of the future benefits to be received by HMRI was recorded in the statement of activities as a temporarily restricted donation in the period the gift was established. The valuation of the CRUT falls into the Level 3 category of the fair value hierarchy, as discussed in Note 15.

The CRUT at September 30, 2015 and 2014 comprises the following:

	<u>2015</u>	<u>2014</u>
Asset	\$ 151,058	\$ 162,985
Liability	(31,754)	(31,342)
	<u>\$ 119,304</u>	<u>\$ 131,643</u>

Note 7 – Land, Buildings, and Equipment

Land, buildings, and equipment consist of the following as of September 30, 2015 and 2014:

	<u>2015</u>	<u>2014</u>
Land	\$ 1,612,298	\$ 1,612,298
Buildings and improvements	5,313,058	5,296,758
Lab equipment	6,416,689	5,052,217
Other equipment	777,733	772,643
Construction in process	1,675,975	743,735
Assets held for future development (Note 8)	3,162,563	3,162,563
	18,958,316	16,640,214
Less accumulated depreciation	8,588,615	7,934,135
	<u>\$ 10,369,701</u>	<u>\$ 8,706,079</u>

**HUNTINGTON MEDICAL RESEARCH INSTITUTES
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2015**

Note 7 – Land, Buildings, and Equipment (continued)

Depreciation expense for the years ended September 30, 2015 and 2014 was \$654,479 and \$482,268, respectively.

Note 8 – Assets Held for Future Development

In order to continue its efforts to provide excellence in medical research, HMRI has developed a facilities expansion plan. As of September 30, 2015, HMRI has purchased several parcels of real property in Pasadena, California. The aggregate purchase cost for these properties is approximately \$3.2 million. Development of these parcels will begin within the next year.

Note 9 – Patents

Amortization expense for the years ended September 30, 2015 and 2014 was \$16,558 and \$21,512, respectively. Total accumulated amortization of patents as of September 30, 2015 and 2014 was \$271,121 and \$254,563, respectively

The estimated aggregate amortization expense for the five years ending subsequent to September 30, 2015 is as follows:

<u>Years Ending September 30,</u>	
2016	\$ 14,087
2017	14,087
2018	14,087
2019	14,087
2020	14,087

Note 10 – Temporary Restrictions on Net Assets

Temporarily restricted net assets are subject to the following restrictions as of September 30, 2015:

Research activities	\$ 2,422,090
Capital expenditures	7,393,259
General operations	4,617,494
Time restrictions	119,304
	<u>\$ 14,552,147</u>

HUNTINGTON MEDICAL RESEARCH INSTITUTES
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2015

Note 11 – Defined Benefit Pension Plan

HMRI has a defined benefit pension plan covering substantially all of its employees hired prior to July 1, 2009. The benefits are based on years of service and the employee's compensation during the highest five of the last ten years of employment. HMRI's funding policy is to contribute monthly the amount needed to satisfy the minimum funding standard required by the Employee Retirement Income Security Act of 1974. Contributions are intended to provide not only for benefits attributed to service rendered to date but also for those expected to be earned in the future.

As of September 30, 2009, HMRI adopted provisions of U.S. GAAP, which requires the recognition of the funded status of the pension plan in the statement of financial position, and recognize changes in the funded or unfunded status through the changes in unrestricted net assets. U.S. GAAP also requires the pension plan's measurement date be the same as HMRI's financial statement date.

The following provides further information about HMRI's pension plan as of September 30, 2015 and 2014:

Benefit obligations and funded status:

	<u>2015</u>	<u>2014</u>
Benefit obligation at September 30	\$ 15,143,688	\$ 13,609,398
Employer contributions	593,316	979,634
Benefit payments	741,930	671,560
Fair value of plan assets at September 30	10,011,048	9,846,097
Net unfunded status of plan	(5,132,640)	(3,763,301)
Accrued pension cost	(5,132,640)	(3,763,301)

Amounts recognized in the statement of financial position consist of:

	<u>2015</u>	<u>2014</u>
Noncurrent assets	\$ -	\$ -
Current liabilities	-	-
Noncurrent liabilities	5,132,640	3,763,301
Net amount recognized	<u>\$ 5,132,640</u>	<u>\$ 3,763,301</u>

Amounts recognized as changes in unrestricted net assets but not yet reclassified as components of net periodic benefit cost consist of:

	<u>2015</u>	<u>2014</u>
Prior service cost	\$ -	\$ 52,297
Actuarial loss	5,933,919	4,515,304
Net amount recognized	<u>\$ 5,933,919</u>	<u>\$ 4,567,601</u>

HUNTINGTON MEDICAL RESEARCH INSTITUTES
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2015

Note 11 – Defined Benefit Pension Plan (continued)

Other changes in net assets not yet included in net periodic benefit cost and reclassifications to net periodic benefit cost of amounts previously recognized as changes in unrestricted net assets but not included in net periodic benefit cost when they arose:

	<u>2015</u>	<u>2014</u>
Actual loss (gain)	\$ 1,421,636	\$ (952,416)
Recognized prior service cost	<u>(52,297)</u>	<u>(67,269)</u>
Total of other changes in unrestricted net assets	<u>\$ 1,369,339</u>	<u>\$ (1,019,685)</u>

The projected benefit obligation, accumulated obligation, and fair value of plan assets for plans with accumulated benefit obligations in excess of plan assets were as follows:

	<u>2015</u>	<u>2014</u>
Projected benefit obligation	\$ 15,143,688	\$ 13,609,398
Accumulated benefit obligation	14,632,137	13,141,072
Fair value of plan assets	10,011,048	9,846,097

The net periodic benefit cost recognized in the change in net assets is as follows:

	<u>2015</u>	<u>2014</u>
Net periodic benefit cost	\$ 738,118	\$ 1,066,624

Amounts expected to be recognized in net periodic cost in the coming year:

	<u>2015</u>	<u>2014</u>
Loss recognition	\$ 397,799	\$ 281,388
Prior service cost recognition	-	52,297

The weighted-average assumptions used to determine benefit obligations at September 30, 2015 and 2014 were as follows:

	<u>2015</u>	<u>2014</u>
Discount rate	5.00%	4.50%
Rate of compensation increase	2.00%	2.00%

The weighted-average assumptions used to determine net periodic benefit cost for the years ended September 30, 2015 and 2014 were as follows:

	<u>2015</u>	<u>2014</u>
Discount rate	4.50%	5.00%
Expected return on plan assets	5.50%	7.00%
Rate of compensation increase	2.00%	3.00%

HUNTINGTON MEDICAL RESEARCH INSTITUTES
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2015

Note 11 – Defined Benefit Pension Plan (continued)

The expected rate of return on pension plan assets is determined by those assets' historical long-term investment performance, current asset allocation, and estimates of future long-term returns by asset class.

HMRI's investments are invested in a fixed income portfolio whose assets are held in a segment of Aetna's general account, with main holdings of bonds and mortgage loans. The investment strategy for the bond portfolio is to improve the income and long-term potential by maintaining a minimal U.S. Treasury position and a significant corporate bond position. Holdings continue to be primarily in investment grade corporate bonds. The investment strategy of the mortgage loan portfolio is to continue to seek opportunity in the commercial mortgage loan markets as existing loans mature and prepay. The target allocations for plan assets are 84% bonds, 14% mortgage loans, and 2% cash and short-term equity. Bond portfolio includes investments in corporate industrial, corporate foreign, corporate utilities, corporate financial, commercial mortgage backed, government, agency mortgage backed, and asset backed. Mortgage loan portfolio includes investments in apartment, retail, office, industrial, and others.

The fair values of HMRI's pension plan assets for the year ended September 30, 2015, by asset class are as follows:

	Assets at Fair Value as of September 30, 2015			
	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Insurance contract	\$ 10,011,048	\$ -	\$ 10,011,048	\$ -

The fair values of HMRI's pension plan assets for the year ended September 30, 2014, by asset class are as follows:

	Assets at Fair Value as of September 30, 2014			
	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Insurance contract	\$ 9,846,097	\$ -	\$ 9,846,097	\$ -

Expected future benefit payments are as follows as of September 30, 2015:

<u>Years Ending September 30,</u>	
2016	\$ 787,907
2017	822,818
2018	831,878
2019	887,348
2020	903,608
2021-2025	4,710,291

HMRI expects to contribute approximately \$780,000 to the pension plan for the year ended September 30, 2016. No plan assets are expected to be returned to HMRI for the year ended September 30, 2016.

HUNTINGTON MEDICAL RESEARCH INSTITUTES
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2015

Note 12 – Defined Contribution Plans

On October 1, 2010, HMRI established a defined contribution retirement plan (the 401(k) Plan) for the benefit of all employees meeting the eligibility requirements as set forth in the 401(k) Plan documents. HMRI may make an annual discretionary contribution up to 4% of employees' compensation and may match up to an additional 4% based on voluntary contributions by employees to the 403(b) plan. During the years ended September 30, 2015 and 2014, HMRI contributed \$29,419 and \$35,667, respectively, to the 401(k) Plan.

HMRI also maintains a 403(b) defined contribution retirement program for all employees who have attained 21 years of age and have completed one year of service. The plan is voluntary on behalf of the employees and HMRI has no obligation to contribute to the plan. HMRI has no liability for the administration or payment of benefits of the plan.

Note 13 – Concentrations

Concentration of Credit Risk

HMRI maintains cash balances at high credit-quality financial institutions where account balances are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000. At September 30, 2015, account balances at two financial institutions exceeded the aforementioned FDIC insurance limit by approximately \$8,812,000. HMRI has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk related to cash and cash equivalents.

HMRI maintains cash balances with various securities' brokerage firms in money market mutual fund accounts. Investments and cash accounts at these institutions are insured by the Securities Investors Protection Corporation (SIPC) up to \$500,000, of which no more than \$250,000 can be cash awaiting reinvestment. At September 30, 2015, HMRI's cash balances included \$1,306,000 in money market mutual funds. However, HMRI has not experienced any loss in such accounts to date and does not anticipate non-performance by the brokerage firm.

Concentration of Grants and Revenue

HMRI received approximately 17% and 24% of its revenue support from federal government programs in 2015 and 2014, respectively. A significant reduction in the level of this support, if it were to occur, would have a pronounced effect on programs and activities.

Note 14 – Related Party Transactions

HMRI owns 28% of Huntington Outpatient Imaging Center (HOPIC). HMRI's share of the partnership income from HOPIC was \$496,231 and \$146,252 for the years ended September 30, 2015 and 2014, respectively.

HMRI leases real property to a board member. The lease calls for base monthly payments of \$7,650 for sixty months commencing on September 1, 2010, with annual consumer price index adjustments, if any. In addition, starting from April 2014, a storage facility was also rented on a month-to-month basis for \$750 per month. For the years ended September 30, 2015 and 2014, rental income from these leases was approximately \$105,064 and \$100,800, respectively.

**HUNTINGTON MEDICAL RESEARCH INSTITUTES
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2015**

Note 15 – Fair Value Measurements

U.S. GAAP establishes a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted market prices in active markets for identical assets or liabilities (Level 1 measurements), and the lowest priority to unobservable inputs in which little or no market data exists (Level 3 measurements). HMRI uses appropriate valuation techniques based on the available inputs to measure the fair value of its investments. When available, HMRI measures fair value using Level 1 inputs because they generally provide the most reliable evidence of fair value. Level 2 inputs are used for other observable inputs other than Level 1 prices in active markets that are either directly or indirectly observable. Level 3 inputs are used only when Level 1 or Level 2 inputs are not available. HMRI's alternative investments, including its limited partnership interests, offshore funds, and a life insurance policy, utilize Level 3 measurements.

Fair values for mutual funds and equity securities are determined by reference to quoted market prices. Fair values for pooled funds are determined by reference to quoted market prices for similar assets and other relevant information generated by market transactions. The fair value of the limited partnership interests and offshore funds are based on information received from the partnerships and offshore funds. Pooled funds, limited partnership interests, offshore funds, and life insurance were measured at fair value using significant unobservable inputs (Level 3) that have quantitative unobservable inputs that are not developed by HMRI when measuring fair value, such as prices from prior transactions or third party pricing information, without adjustment.

HMRI measured the charitable remainder unitrust at fair value using significant unobservable inputs (Level 3) with various quantitative information used in the measurement. On an annual basis, HMRI revalues the liability to make distributions to the life income beneficiary based on actuarial assumptions. The present value of the estimated future payments is calculated using a discount rate, as provided in Internal Revenue Service tables, and applicable mortality tables. The discount rate was 2.2% for the amounts owed at September 30, 2015 and 2014.

Fair values of assets measured on a recurring basis at September 30, 2015 are as follows:

<u>2015</u>	Assets at Fair Value as of September 30, 2015			
	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Investments:				
Cash held for investment	\$ 3,962,910	\$ 3,962,910	\$ -	\$ -
Common stock	5,948,858	5,948,858	-	-
Mutual funds	14,838,863	14,838,863	-	-
Pooled funds	1,723,528	-	1,723,528	-
Limited partnership interests	5,933,379	732,058	1,046,187	4,155,134
Offshore funds	8,111,818	-	-	8,111,818
Life insurance	8,628	-	-	8,628
Charitable remainder unitrust	119,304	-	-	119,304
	<u>\$ 40,647,288</u>	<u>\$ 25,482,689</u>	<u>\$ 2,769,715</u>	<u>\$ 12,394,884</u>

HUNTINGTON MEDICAL RESEARCH INSTITUTES
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2015

Note 15 – Fair Value Measurements (continued)

Assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3):

	Pooled Funds, Limited Partnership Interests, Offshore Funds, and Life Insurance	Charitable Remainder Unitrust
Balance, September 30, 2014	\$ 13,320,575	\$ 131,643
Additions	1,836,308	-
Net income	1,202,156	15
Unrealized losses	(627,524)	(37)
Withdrawals and distributions	(3,455,935)	(12,317)
Balance, September 30, 2015	<u>\$ 12,275,580</u>	<u>\$ 119,304</u>

The change in value of the pooled funds, limited partnership interests, and offshore funds which include net income, realized and unrealized gains and losses are included in the statement of activities for the year ended September 30, 2015. The change in value of the charitable remainder unitrust is attributable to the revaluation of the present value of the remainder interest and is included in the statement of activities for the year ended September 30, 2015.

Fair values of assets measured on a recurring basis at September 30, 2014 are as follows:

2014	Assets at Fair Value as of September 30, 2014			
	Total	Level 1	Level 2	Level 3
Investments:				
Cash held for investment	\$ 2,252,777	\$ 2,252,777	\$ -	\$ -
Common stock	6,095,289	6,095,289	-	-
Mutual funds	17,089,692	17,089,692	-	-
Pooled funds	1,483,075	-	1,483,075	-
Limited partnership interests	5,792,593	1,160,243	1,128,763	3,503,587
Offshore funds	9,808,360	-	-	9,808,360
Life insurance	8,628	-	-	8,628
Charitable remainder unitrust	131,643	-	-	131,643
	<u>\$ 42,662,057</u>	<u>\$ 26,598,001</u>	<u>\$ 2,611,838</u>	<u>\$ 13,452,218</u>

HUNTINGTON MEDICAL RESEARCH INSTITUTES
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2015

Note 15 – Fair Value Measurements (continued)

Assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3):

	Pooled Funds, Limited Partnership Interests, Offshore Funds, and Life Insurance	Charitable Remainder Unitrust
Balance, September 30, 2013	\$ 12,502,930	\$ 138,846
Additions	937,285	-
Net income	465,263	-
Unrealized gains	699,499	5,114
Withdrawals and distributions	(1,284,402)	(12,317)
Balance, September 30, 2014	<u>\$ 13,320,575</u>	<u>\$ 131,643</u>

The change in value of the pooled funds, limited partnership interests, and offshore funds which include net income, realized and unrealized gains are included in the statement of activities for the year ended September 30, 2014. The change in value of the charitable remainder unitrust is attributable to the reevaluation of the present value of the remainder interest and is included in the statement of activities for the year ended September 30, 2014.

Note 16 – Endowment

HMRI's endowment consists of unrestricted board-designated endowment funds including the Hacker Fund, and the permanently restricted McCollum Fund. The unrestricted board-designated endowment funds are comprised of gifts received over the years that could be used at HMRI's discretion for unrestricted use. In 1991, HMRI received a permanently restricted endowment contribution and the McCollum Fund was created pursuant to the provisions of the trust created under the Will of Ross McCollum. Under the trust provisions, the corpus of the endowment is to remain intact and the income earned from appreciation of the corpus is available for HMRI's unrestricted use. In 2015, HMRI received a permanently restricted endowment contribution and the Ingram Fund was created pursuant to the provisions of the trust created by Marylou Ingram. Under the trust provisions, the corpus of the endowment is to remain intact and the income earned from appreciation of the corpus is available for research in tissue engineering, cancer molecular genetics, and other related research programs. As required by U.S. GAAP, net assets associated with the endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

HUNTINGTON MEDICAL RESEARCH INSTITUTES
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2015

Note 16 – Endowment (continued)

HMRI adheres to U.S. GAAP with respect to the endowment funds. The State of California has adopted a version of the Uniform Prudent Management of Institutional Funds Act (UPMIFA). The Board has interpreted UPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds, absent explicit donor stipulations to the contrary. The Board has further interpreted this to mean that there is an implicit understanding that the market value of the donor-restricted endowment may, from time to time, fall below the fair value of the original gift as of the gift date due to market conditions or continued prudent expenditures by the Board of certain amounts of the endowment. If such a temporary deficit condition occurred, the Board would take all prudent steps, given ongoing market conditions, to restore the fair value of the fund to an amount at or above the amount of the original gift.

As a result of this interpretation, HMRI classifies as permanently restricted net assets a) the original value of gifts donated to the permanent endowment, b) the original value of subsequent gifts to the permanent endowment, and c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by HMRI in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, HMRI considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- (1) The duration and preservation of the fund
- (2) The purposes of HMRI and the donor-restricted endowment fund
- (3) General economic conditions
- (4) The possible effect of inflation and deflation
- (5) The expected total return from income and the appreciation of investments
- (6) Other resources of HMRI
- (7) The investment policies of HMRI

The endowment consists of a portfolio of investments comprised of mutual funds, common stock, pooled funds, limited partnership interests, and offshore funds. The fiduciary responsibility for HMRI's portfolio is assigned to the Board delegated Investment Committee (Committee). The Committee takes responsibility for allocation of funds to various asset classes; Board approved policy, and the engagement of investment managers. The Committee will normally review the portfolio's asset allocation, manager structure, and performance quarterly in order to evaluate diversification, adherence to policies, and progress towards long-term objectives. While short-term results will be monitored, it is understood that the objectives of the portfolio are long-term in nature and that progress toward these objectives will be evaluated from a long-term prospective.

The primary long-term financial objectives of the portfolio are to maintain and grow the real value (purchasing power) of the fund in perpetuity, while providing a relatively stable and growing source of funding to support HMRI's operations. The primary long-term investment objective of the portfolio is to earn an average annual real (after adjusting for inflation) total return that exceeds the Board approved total spending rate (generally 4%), net of consultant and management fees, over long time periods (rolling twenty-year periods). The Board recognizes that the investment objectives involve risk and though it cannot be eliminated, can be mitigated by diversification and other risk management methods.

HUNTINGTON MEDICAL RESEARCH INSTITUTES
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2015

Note 16 – Endowment (continued)

HMRI maintains master investment accounts for its donor-restricted and board-designated endowments. Pooling endowment funds for investment purposes has many benefits, including but not limited to spreading the total risk for each endowment fund and making the risk equal for all funds invested in the master investment accounts, enhancing the investment performance relative to that of an individual fund, and reducing management fees. Realized and unrealized gains and losses from securities in the master investment accounts are allocated monthly to the individual endowments based on the relationship of the fair value of each endowment to the total fair value of the master investment accounts, as adjusted for additions to or deductions from those accounts.

A summary of endowment fund balances by type of fund and changes in these net assets as of and for the year ended September 30, 2015 is as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment	\$ -	\$ 4,617,494	\$ 5,486,792	\$ 10,104,286
Board-designated endowment	29,506,336	-	-	29,506,336
Endowment net assets, end of year	<u>\$ 29,506,336</u>	<u>\$ 4,617,494</u>	<u>\$ 5,486,792</u>	<u>\$ 39,610,622</u>

Changes in endowment net assets for the fiscal year ended September 30, 2015 are as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ 32,795,448	\$ 5,511,315	\$ 3,486,792	\$ 41,793,555
Contributions	-	-	2,000,000	2,000,000
Investment return:				
Investment income	341,019	92,219	-	433,238
Realized gains on investments	1,415,670	382,829	-	1,798,499
Unrealized losses on investments	(2,996,636)	(707,672)	-	(3,704,308)
Total Investment Return	(1,239,947)	(232,624)	-	(1,472,571)
Appropriation of endowment assets for expenditure	(2,049,165)	(661,197)	-	(2,710,362)
Endowment net assets, end of year	<u>\$ 29,506,336</u>	<u>\$ 4,617,494</u>	<u>\$ 5,486,792</u>	<u>\$ 39,610,622</u>

HUNTINGTON MEDICAL RESEARCH INSTITUTES
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2015

Note 16 – Endowment (continued)

A summary of endowment fund balances by type of fund and changes in these net assets as of and for the year ended September 30, 2014 is as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment	\$ -	\$ 5,511,315	\$ 3,486,792	\$ 8,998,107
Board-designated endowment	32,795,448	-	-	32,795,448
Endowment net assets, end of year	<u>\$ 32,795,448</u>	<u>\$ 5,511,315</u>	<u>\$ 3,486,792</u>	<u>\$ 41,793,555</u>

Changes in endowment net assets for the fiscal year ended September 30, 2014 are as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ 31,950,971	\$ 5,466,931	\$ 3,486,792	\$ 40,904,694
Investment Return:				
Investment income	322,412	89,405	-	411,817
Realized gains on investments	2,059,038	570,976	-	2,630,014
Unrealized gains on investments	288,122	79,897	-	368,019
Total Investment Return	2,669,572	740,278	-	3,409,850
Appropriation of endowment assets for expenditure	(1,825,095)	(695,894)	-	(2,520,989)
Endowment net assets, end of year	<u>\$ 32,795,448</u>	<u>\$ 5,511,315</u>	<u>\$ 3,486,792</u>	<u>\$ 41,793,555</u>

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or UPMIFA requires HMRI to retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature that are reported in unrestricted net assets were \$114,123 as of September 30, 2015. These deficiencies resulted from unfavorable market fluctuations that occurred shortly after the investment of new permanently restricted contributions. There were no such deficiencies as of September 30, 2014.

HUNTINGTON MEDICAL RESEARCH INSTITUTES
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2015

Note 17 – Commitments and Contingencies

Operating Leases

HMRI is committed to a lease agreement for a building, expiring in June, 2020. The future minimum rental commitment under the lease are as follows:

<u>Years Ending September 30,</u>	
2016	\$ 245,889
2017	253,266
2018	260,864
2019	268,690
2020	<u>206,018</u>
	<u>\$ 1,234,727</u>

Rent expense for the years ended September 30, 2015 and 2014 was approximately \$241,000 and \$268,000, respectively.

Unfunded Capital Commitments

HMRI is committed to provide additional capital to certain limited partnerships based on the capital call provisions of those partnerships. As of September, 30, 2015 and 2014, HMRI's unfunded commitments to these limited partnerships were \$1,082,500 and \$1,412,500, respectively.

Noncompliance with Laws and Regulations

As of September 30, 2015, HMRI is involved in proceedings with the U.S. Department of Health and Human Services (HSS) concerning noncompliance with certain provisions of the Health Insurance Portability and Accountability Act of 1996 (HIPAA). HMRI self-reported the noncompliance to HSS once the violation was discovered. At the conclusion of proceedings, HSS may impose a noncompliance penalty on HMRI. The noncompliance penalty is based on the level of negligence and ranges from \$100 to \$50,000 per violation, with a maximum penalty of \$1,500,000 per year for violations of an identical requirement or provision. Management believes any actions that may results from these proceedings will not have a material effect on the Organization's future financial position or results of operations.

Note 18 – Subsequent Events

Management has evaluated subsequent events through March 16, 2016, the date the financial statements were available to be issued.

At its January 2016 meeting, the Board passed a resolution to amend the defined benefit pension plan. As a result of this amendment, employee compensation levels earned and hours of service credited after February 14, 2016, will not factor into future benefit calculations. In addition, an employee's pension benefit shall not be less than his or her accrued pension benefit as of February 14, 2016. The disclosures and calculations related to the defined benefit pension plan (see Note 11) have not incorporated these changes, and the impact of such changes has not been determined as of March 16, 2016.