

Financial Statements

HUNTINGTON MEDICAL RESEARCH INSTITUTES

For the Year Ended September 30, 2017

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INDEPENDENT AUDITOR'S REPORT

Board of Directors
Huntington Medical Research Institutes
Pasadena, California

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, 2017, 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 appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Huntington Medical Research Institutes as of September 30, 2017, 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' 2016 financial statements and we expressed an unmodified audit opinion on those audited financial statements in our report dated March 15, 2017. In our opinion, the summarized comparative information presented herein as of and for the year ended September 30, 2016, 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 CPA". The signature is written in a cursive, flowing style.

May 9, 2018

HUNTINGTON MEDICAL RESEARCH INSTITUTES
STATEMENT OF FINANCIAL POSITION
SEPTEMBER 30, 2017
With Comparative Totals for 2016

ASSETS

	2017	2016
Assets		
Cash and cash equivalents	\$ 5,631,484	\$ 478,817
Government and other contract receivables	226,895	180,919
Other receivables	204,359	93,200
Unconditional promises to give	3,229,670	899,336
Prepaid expenses	40,013	74,783
Cash designated for capital expenditures	-	6,732,549
Investments	35,254,737	39,065,570
Land, buildings, and equipment, net	28,706,437	15,383,472
Beneficial interest in a charitable remainder unitrust	110,014	116,524
Patents, net	125,861	134,983
Patent deposits	253,705	224,460
	\$ 73,783,175	\$ 63,384,613

LIABILITIES AND NET ASSETS

Liabilities		
Accounts payable	\$ 1,988,788	\$ 911,685
Accrued expenses and deposits	602,193	357,582
Deferred revenue	37,998	49,934
Accrued pension cost	4,436,425	4,971,818
	7,065,404	6,291,019
Net Assets		
Unrestricted net assets		
Undesignated	21,595,616	9,468,202
Designated by the Board	31,183,825	34,361,964
	52,779,441	43,830,166
Temporarily restricted net assets	8,451,538	7,776,636
Permanently restricted net assets	5,486,792	5,486,792
	66,717,771	57,093,594
Total Liabilities and Net Assets	\$ 73,783,175	\$ 63,384,613

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, 2017
With Comparative Totals for 2016

	2017			2016	
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
Support, Revenue, Gains, and Investment Return					
Specific research:					
Government funded grants and contracts	\$ 2,396,986	\$ -	\$ -	\$ 2,396,986	\$ 2,535,507
Privately funded grants, contracts and projects	49,865	384,078	-	433,943	454,027
Partnership income	502,431	-	-	502,431	519,552
Donations	677,658	8,102,633	-	8,780,291	2,034,328
Bequests	194,977	-	-	194,977	70,269
Rental income	279,139	-	-	279,139	259,218
Loss in value - charitable remainder unitrust	-	(6,618)	-	(6,618)	(2,261)
Gain (loss) on disposal of fixed assets	(29,446)	-	-	(29,446)	5,494,608
Clinical and royalty income	1,186,393	-	-	1,186,393	654,083
Total Support and Revenue	5,258,003	8,480,093	-	13,738,096	12,019,331
Other Gains and Losses					
Special Events					
Special event contributions	69,565	-	-	69,565	61,455
Special event expense	(48,597)	-	-	(48,597)	(46,894)
Net Special Event	20,968	-	-	20,968	14,561
Net Assets Released Due to Satisfaction of Restrictions	8,962,508	(8,962,508)	-	-	-
Investment Return Designated for Current Operations	8,457,193	-	-	8,457,193	3,481,510
Total Support, Revenue, Gains, and Investment Return	22,698,672	(482,415)	-	22,216,257	15,515,402
Expenses					
Research	6,585,722	-	-	6,585,722	6,959,193
Research support services:					
General	1,949,624	-	-	1,949,624	1,974,322
Fundraising	748,044	-	-	748,044	915,404
Total Research Support Services	2,697,668	-	-	2,697,668	2,889,726
Total Expenses	9,283,390	-	-	9,283,390	9,848,919
Change in Net Assets from Operations	13,415,282	(482,415)	-	12,932,867	5,666,483

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, 2017
With Comparative Totals for 2016
(CONTINUED)

	2017			2016	
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
Net Investment Return					
Interest and dividends	\$ 595,856	\$ 215,527	\$ -	\$ 811,383	\$ 261,590
Realized gains on investments	1,361,974	425,064	-	1,787,038	542,849
Unrealized gains on investments	1,531,662	516,726	-	2,048,388	1,037,382
Investment fees	(33,699)	-	-	(33,699)	(116,339)
Total Net Investment Return	3,455,793	1,157,317	-	4,613,110	1,725,482
Less Investment Return Designated for Current Operations	(8,457,193)	-	-	(8,457,193)	(3,481,510)
Investment Return Reduced by the Portion of Net Investment Return Designated for Current Operations	(5,001,400)	1,157,317	-	(3,844,083)	(1,756,028)
Change in Net Assets Before Pension-related Changes Other Than Net Periodic Pension Cost	8,413,882	674,902	-	9,088,784	3,910,455
Pension-related Changes Other Than Net Periodic Pension Cost	535,393	-	-	535,393	160,822
Change in Net Assets	8,949,275	674,902	-	9,624,177	4,071,277
Net Assets, Beginning	43,830,166	7,776,636	5,486,792	57,093,594	53,022,317
Net Assets, Ending	\$ 52,779,441	\$ 8,451,538	\$ 5,486,792	\$ 66,717,771	\$ 57,093,594

The accompanying notes are an integral part of these statements.

HUNTINGTON MEDICAL RESEARCH INSTITUTES
STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED SEPTEMBER 30, 2017
With Comparative Totals for 2016

	<u>2017</u>			<u>2016</u>	
	<u>Research Support Services</u>			<u>Total</u>	<u>Total</u>
	<u>Research</u>	<u>General</u>	<u>Fundraising</u>		
Salaries and wages	\$ 2,387,857	\$ 786,650	\$ 313,962	\$ 3,488,469	\$ 3,623,485
Payroll taxes and employee benefits	1,377,123	455,015	181,200	2,013,338	1,560,091
Total Personnel Costs	3,764,980	1,241,665	495,162	5,501,807	5,183,576
Occupancy and related expenses	549,889	398,857	9,583	958,329	689,709
Research and other supplies	647,638	(1,225)	34,022	680,435	802,555
Professional fees and contract service payments	254,341	200,653	113,748	568,742	1,372,282
Office and other expenses	251,325	55,402	76,682	383,409	448,222
Repairs, maintenance, and service contracts	232,185	14,265	2,489	248,939	322,549
Insurance	116,664	13,258	2,651	132,573	169,565
Taxes and licenses	62,483	7,100	1,420	71,003	86,783
Travel, conferences, conventions and meetings	26,740	1,929	12,287	40,956	46,882
Impairment loss on patents and patent deposits	2,580	-	-	2,580	60,184
Total Expenses Before Depreciation and Amortization	5,908,825	1,931,904	748,044	8,588,773	9,182,307
Depreciation and amortization	676,897	51,419	-	728,316	782,951
Total Expenses	6,585,722	1,983,323	748,044	9,317,089	9,965,258
Less Expenses Included with Investment Return in the Statement of Activities and Changes in Net Assets	-	(33,699)	-	(33,699)	(116,339)
Total Expenses Included in the Expenses Section of the Statement of Activities and Changes in Net Assets	<u>\$ 6,585,722</u>	<u>\$ 1,949,624</u>	<u>\$ 748,044</u>	<u>\$ 9,283,390</u>	<u>\$ 9,848,919</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, 2017
With Comparative Totals for 2016

	2017	2016
Cash Flows from Operating Activities		
Cash received from service recipients	\$ 3,693,447	\$ 2,962,755
Cash received from donors	1,393,184	1,102,632
Cash received from interest and dividends	811,383	261,590
Cash paid to suppliers and employees	(6,743,304)	(8,283,309)
Net Cash Used in Operating Activities	(845,290)	(3,956,332)
Cash Flows from Investing Activities		
Purchase of land, buildings, and equipment	(14,068,789)	(6,253,433)
Proceeds from sale of land and buildings	-	5,961,778
Purchase of investments	(7,056,875)	(30,269,281)
Proceeds from sale of investments	14,642,237	33,375,078
Distributions from partnership	850,039	456,400
Deposits paid on patents	(31,825)	(45,787)
Proceeds from cash designated for capital expenditures	6,732,549	6,478,448
Purchase of cash designated for capital expenditures	(295,732)	(7,780,509)
Net Cash Provided by Investing Activities	771,604	1,922,694
Cash Flows from Financing Activities		
Contributions restricted for capital campaign	5,226,353	1,818,731
Net Increase (Decrease) in Cash and Cash Equivalents	5,152,667	(214,907)
Cash and Cash Equivalents, Beginning	478,817	693,724
Cash and Cash Equivalents, Ending	\$ 5,631,484	\$ 478,817
Reconciliation of Change in Net Assets to		
Net Cash Used in Operating Activities		
Change in net assets	\$ 9,624,177	\$ 4,071,277
Adjustments to reconcile change in net assets to net cash used in operating activities:		
(Gain) loss on disposition of fixed assets	29,446	(5,494,608)
Depreciation and amortization	728,316	782,951
Net realized and unrealized gains on investments	(3,835,426)	(1,580,231)
Loss in value - charitable remainder unitrust	6,510	2,780
Partnership income	(502,431)	(519,552)
Loss on write-down of unconditional promises to give	135,000	65,000
Impairment loss on patents and patent deposits	2,580	60,184
Contributions restricted for capital expenditures, net	(4,094,489)	(1,064,047)
Amortization of discount on unconditional promises to give	51,802	(21,025)
(Increase) decrease in:		
Government and other contract receivables	(45,976)	11,138
Other receivables	(111,159)	(40,308)
Unconditional promises to give	(3,649,000)	(146,000)
Prepaid expenses	34,770	(4,975)
Increase (decrease) in:		
Accounts payable	1,083,308	363,442
Accrued expenses and deposits	244,611	175,347
Deferred revenue	(11,936)	(456,883)
Accrued pension cost	(535,393)	(160,822)
Net Cash Used in Operating Activities	\$ (845,290)	\$ (3,956,332)

The accompanying notes are an integral part of these statements.

HUNTINGTON MEDICAL RESEARCH INSTITUTES
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2017

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, 2016, 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.

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.

HUNTINGTON MEDICAL RESEARCH INSTITUTES
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2017

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

Support and Revenue (continued)

Unconditional promises to give are recognized as revenues or gains in the period received. Promises to give that are due in the next year are recorded at their net realized value; those due in subsequent years are recorded at the present value of their net realizable value, discounted using low-risk interest rates applicable to the year in which the promise was received. 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 established.

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, HMRI 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 contract receivables 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 contract receivables are fully collectible as of **REPORT DATE**; 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 Board-designated funds and temporarily restricted contributions received as part of HMRI's capital campaign, which are awaiting expenditure according to HMRI's facilities' expansion plan (Note 8).

Investments

Investments are reported at their fair values in the statements of financial position. Unrealized gains and losses are included in the changes in net assets. Gains and losses are considered unrestricted or temporarily restricted depending on whether external restrictions were imposed on the gains and losses at the time of the initial investment.

Patents

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

HUNTINGTON MEDICAL RESEARCH INSTITUTES
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2017

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

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.

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. For the years ended September 30, 2017 and 2016, HMRI recorded an impairment loss of \$2,580 and \$60,184, respectively, related to patents and patent deposits.

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. At September 30, 2017, the unrestricted net assets include Board-designated balances of \$31,183,825 for investment activities and capital expenditures (Note 8).

HUNTINGTON MEDICAL RESEARCH INSTITUTES
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2017

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, 2017, the temporarily restricted net assets totaled \$8,451,538.

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 upon her death in 2013. 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, 2017

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.

Note 2 – Unconditional Promises to Give

As of September 30, 2017, unconditional promises to give are scheduled to be collected as follows:

Promises scheduled to be collected in one year or less	\$ 816,084
Promises scheduled to be collected in one to five years	2,482,756
Promises scheduled to be collected in five years or more	<u>36,110</u>
Gross unconditional promises to give	3,334,950
Less discount to present value at 2%	<u>105,280</u>
Unconditional promises to give at present value	<u><u>\$ 3,229,670</u></u>

Note 3 – Conditional Promises to Give

In 2011, HMRI received a conditional promise to give of \$500,000. The first payment of \$250,000 was received in March 2016 when HMRI received a building permit and began construction as part of its expansion plan (Note 8). It was recorded as a donation at the time the donation was received. During March 2018, a certificate of occupancy was issued, and the second payment of \$250,000 was received by HMRI. However, as of September 30, 2017, the building had not been completed; therefore, the conditional promise to give was not recorded as a donation.

HUNTINGTON MEDICAL RESEARCH INSTITUTES
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2017

Note 3 – Conditional Promises to Give (continued)

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). During February 2018, the construction was substantially completed, and a payment of \$1,000,000 was received by HMRI. As of September 30, 2017, 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, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Liver Center salaries	\$ 46,628	\$ 55,855
Huntington Outpatient Imaging Center (Note 14)	6,936	6,936
Huntington Trust	20,948	-
Other miscellaneous receivables	<u>129,847</u>	<u>30,409</u>
	<u>\$ 204,359</u>	<u>\$ 93,200</u>

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

Note 5 – Investments

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.

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.

HUNTINGTON MEDICAL RESEARCH INSTITUTES
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2017

Note 5 – Investments (continued)

As of September 30, 2017 and 2016, investments consist of the following:

<u>2017</u>	<u>Aggregate Fair Value</u>	<u>Cost</u>
Cash being held for investment	\$ 1,750,137	\$ 1,750,137
Mutual funds	27,381,977	25,586,424
Limited partnership interests	4,622,788	3,520,669
Offshore funds	1,491,207	1,411,308
Life insurance	8,628	8,628
	<u>\$ 35,254,737</u>	<u>\$ 32,277,166</u>

<u>2016</u>	<u>Aggregate Fair Value</u>	<u>Cost</u>
Cash being held for investment	\$ 727,827	\$ 727,827
Mutual funds	30,851,639	29,687,650
Limited partnership interests	4,433,397	3,622,151
Offshore funds	3,044,079	3,027,956
Life insurance	8,628	8,628
	<u>\$ 39,065,570</u>	<u>\$ 37,074,212</u>

Investments by net asset class were as follows as of September 30, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Unrestricted	\$ 24,105,897	\$ 29,074,047
Temporarily restricted	5,662,048	4,504,731
Permanently restricted	5,486,792	5,486,792
	<u>\$ 35,254,737</u>	<u>\$ 39,065,570</u>

Investments by intended purpose were as follows as of September 30, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Undesignated	\$ 992,669	\$ 673,861
Capital campaign	-	331,619
Endowments	34,262,068	38,060,090
	<u>\$ 35,254,737</u>	<u>\$ 39,065,570</u>

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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, 2017 and 2016 comprises the following:

	<u>2017</u>	<u>2016</u>
Asset	\$ 130,218	\$ 139,950
Liability	<u>(20,204)</u>	<u>(23,426)</u>
	<u>\$ 110,014</u>	<u>\$ 116,524</u>

Note 7 – Land, Buildings, and Equipment

Land, buildings, and equipment consist of the following as of September 30, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Land	\$ 2,506,062	\$ 2,506,062
Buildings and improvements	4,278,891	4,278,891
Leasehold improvements	99,101	99,101
Lab equipment	6,638,252	6,461,615
Other equipment	799,755	786,540
Construction in progress	21,517,011	7,866,040
Assets held for future development (Note 8)	<u>1,962,563</u>	<u>1,962,563</u>
	37,801,635	23,960,812
Less accumulated depreciation	<u>9,095,198</u>	<u>8,577,340</u>
	<u>\$ 28,706,437</u>	<u>\$ 15,383,472</u>

Depreciation expense for the years ended September 30, 2017 and 2016 was \$719,194 and \$772,492, respectively.

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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, 2016, 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 some of these parcels, including a new facility for HMRI, began during the year ended September 30, 2016. In March of 2018, a certificate of occupancy was issued for the new facility. As of September 30, 2017 and 2016, approximately \$1.2 million is included in land and approximately \$2 million is included in assets held for future development. In addition, during 2017 and 2016, HMRI incurred approximately \$13.6 million and \$7.9 million in capital expenditures, respectively, for development of its new facility, which are included in construction in progress.

Note 9 – Patents

Patents at September 30, 2017 and 2016 comprise the following:

	<u>2017</u>	<u>2016</u>
Patents	\$ 376,162	\$ 376,162
Less accumulated amortization	<u>250,301</u>	<u>241,179</u>
	<u>\$ 125,861</u>	<u>\$ 134,983</u>

Amortization expense for the years ended September 30, 2017 and 2016 was \$9,122 and \$10,459, respectively.

The estimated aggregate amortization expense for the five years ending subsequent September 30, 2017, is as follows:

<u>Years Ending September 30,</u>	
2018	\$ 9,122
2019	9,122
2020	9,122
2021	9,122
2022	9,122

Note 10 – Temporary Restrictions on Net Assets

Temporarily restricted net assets are subject to the following restrictions as of September 30, 2017:

Research activities	\$ 1,663,237
Capital expenditures	1,335,496
General operations	5,342,791
Time restrictions	<u>110,014</u>
	<u>\$ 8,451,538</u>

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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.

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.

HMRI recognizes the funded status of the pension plan in the statement of financial position and recognizes changes in the funded or unfunded status through the changes in unrestricted net assets. The pension plan's measurement date is the same as HMRI's financial statement date.

The following provides further information about HMRI's pension plan as of September 30, 2017 and 2016:

Benefit obligations and funded status:

	<u>2017</u>	<u>2016</u>
Benefit obligation at September 30	\$ 15,060,392	\$ 15,315,944
Employer contributions	745,384	799,066
Benefit payments	760,160	761,661
Fair value of plan assets at September 30	10,623,967	10,344,126
Net unfunded status of plan	(4,436,425)	(4,971,818)
Accrued pension cost	(4,436,425)	(4,971,818)

Amounts recognized in the statement of financial position consist of:

	<u>2017</u>	<u>2016</u>
Liabilities	\$ 4,436,425	\$ 4,971,818

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

	<u>2017</u>	<u>2016</u>
Actuarial loss	\$ 5,795,493	\$ 6,061,016

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>2017</u>	<u>2016</u>
Actual gain	\$ (535,393)	\$ (160,822)

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Note 11 – Defined Benefit Pension Plan (continued)

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>2017</u>	<u>2016</u>
Projected benefit obligation	\$ 15,060,392	\$ 15,315,944
Accumulated benefit obligation	15,060,392	15,315,944
Fair value of plan assets	10,623,967	10,344,126

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

	<u>2017</u>	<u>2016</u>
Net periodic benefit cost	\$ 475,514	\$ 511,147

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

	<u>2017</u>	<u>2016</u>
Loss recognition	\$ 428,089	\$ 447,130
Prior service cost recognition	-	-

The weighted-average assumptions used to determine benefit obligations at September 30, 2017 and 2016 were as follows:

	<u>2017</u>	<u>2016</u>
Discount rate	4.0%	4.0%
Rate of compensation increase	2.0%	2.0%

The weighted-average assumptions used to determine net periodic benefit cost for the years ended September 30, 2017 and 2016 were as follows:

	<u>2017</u>	<u>2016</u>
Discount rate	4.0%	4.5%
Expected return on plan assets	5.5%	5.5%
Rate of compensation increase	2.0%	2.0%

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.

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Note 11 – Defined Benefit Pension Plan (continued)

The fair values of HMRI’s pension plan assets for the year ended September 30, 2017, by asset class are as follows:

	Assets at Fair Value as of September 30, 2017			
	Total	Level 1	Level 2	Level 3
Insurance contract	\$ 10,623,967	\$ -	\$ 10,623,967	\$ -

The fair values of HMRI’s pension plan assets for the year ended September 30, 2016, by asset class are as follows:

	Assets at Fair Value as of September 30, 2016			
	Total	Level 1	Level 2	Level 3
Insurance contract	\$ 10,344,126	\$ -	\$ 10,344,126	\$ -

Expected future benefit payments are as follows as of September 30, 2017:

Years Ending September 30,	
2018	\$ 822,398
2019	870,519
2020	882,709
2021	908,842
2022	904,690
2023-2027	4,521,569

HMRI expects to contribute approximately \$500,000 to the pension plan for the year ending September 30, 2018. No plan assets are expected to be returned to HMRI for the year ending September 30, 2018.

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, 2017 and 2016, HMRI contributed \$240,791 and \$199,846, 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.

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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, 2017, account balances at two financial institutions exceeded the aforementioned FDIC insurance limit by approximately \$6,169,000. 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 at these institutions are insured by the Securities Investors Protection Corporation (SIPC) up to \$500,000, and cash balances are insured by the FDIC up to \$250,000. At September 30, 2017, HMRI's cash balance in one investment account exceeded the FDIC insurance limit by approximately \$1,250,000. 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 16% of its support and revenue from federal government programs in 2017 and 2016, 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 \$502,431 and \$519,552 for the years ended September 30, 2017 and 2016, respectively.

HMRI leases real property to a Board member. The lease calls for base monthly payments of \$7,650 for 60 months commencing on September 1, 2010, with annual consumer price index adjustments, if any. In addition, in April 2014, a storage facility was also rented on a month-to-month basis for \$750 per month. For the years ended September 30, 2017 and 2016, rental income from these leases was approximately \$106,000 and \$100,000, respectively.

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.

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Note 15 – Fair Value Measurements (continued)

Fair values for mutual funds are determined by reference to quoted market prices. The fair value of the limited partnership interests and offshore funds are based on information received from the partnerships. 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 2.4% and 2.2% for the amounts owed at September 30, 2017 and 2016, respectively.

Fair values of assets measured on a recurring basis as of September 30, 2017, are as follows:

	Assets at Fair Value as of September 30, 2017			
	Total	Level 1	Level 2	Level 3
Investments:				
Cash held for investment	\$ 1,750,137	\$ 1,750,137	\$ -	\$ -
Mutual funds	27,381,977	27,381,977	-	-
Limited partnership interests	4,622,788	-	-	4,622,788
Offshore funds	1,491,207	-	-	1,491,207
Life insurance	8,628	-	-	8,628
Charitable remainder unitrust	110,014	-	-	110,014
	\$ 35,364,751	\$ 29,132,114	\$ -	\$ 6,232,637

The following table summarizes the changes in the fair value of the Level 3 assets for the year ended September 30, 2017:

	Investments	Charitable Remainder Unitrust
Balance, September 30, 2016	\$ 7,486,104	\$ 116,524
Additions	749,006	-
Net income	-	281
Unrealized gains	354,200	3,048
Withdrawals and distributions	(2,466,687)	(9,839)
Balance, September 30, 2017	\$ 6,122,623	\$ 110,014

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Note 15 – Fair Value Measurements (continued)

The change in value of the Level 3 investments, which includes unrealized gains and losses, is included in the statement of activities for the year ended September 30, 2017. 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, 2017.

Fair values of assets measured on a recurring basis at September 30, 2016 are as follows:

	Assets at Fair Value as of September 30, 2016			
	Total	Level 1	Level 2	Level 3
Investments:				
Cash held for investment	\$ 727,827	\$ 727,827	\$ -	\$ -
Mutual funds	30,851,639	30,851,639	-	-
Limited partnership interests	4,433,397	-	-	4,433,397
Offshore funds	3,044,079	-	-	3,044,079
Life insurance	8,628	-	-	8,628
Charitable remainder unitrust	116,524	-	-	116,524
	\$ 39,182,094	\$ 31,579,466	\$ -	\$ 7,602,628

The following table summarizes the changes in the fair value of the Level 3 assets for the year ended September 30, 2016:

	Investments	Charitable Remainder Unitrust
Balance, September 30, 2015	\$ 12,275,580	\$ 119,304
Additions	1,967,648	-
Net income	413,056	104
Unrealized losses	129,107	7,668
Withdrawals and distributions	(7,299,287)	(10,588)
Balance, September 30, 2016	\$ 7,486,104	\$ 116,524

The change in value of Level 3 investments, which include net income and unrealized gains and losses, is included in the statement of activities for the year ended September 30, 2016. 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, 2016.

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Note 16 – Endowment

HMRI's endowment consists of unrestricted Board-designated endowment funds and the permanently restricted McCollum Fund and Ingram 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.

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

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Note 16 – Endowment (continued)

The endowment consists of a portfolio of investments comprised of mutual 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.

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 as of September 30, 2017, is as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment	\$ -	\$ 5,342,791	\$ 5,486,792	\$ 10,829,583
Board-designated endowment	23,432,485	-	-	23,432,485
Endowment net assets, end of year	<u>\$ 23,432,485</u>	<u>\$ 5,342,791</u>	<u>\$ 5,486,792</u>	<u>\$ 34,262,068</u>

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Note 16 – Endowment (continued)

Changes in endowment net assets for the year ended September 30, 2017, are as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ 28,400,186	\$ 4,173,112	\$ 5,486,792	\$ 38,060,090
Investment return:				
Investment income	595,856	215,527	-	811,383
Realized gains on investments	1,361,974	425,064	-	1,787,038
Unrealized gains on investments	1,531,662	529,088	-	2,060,750
Total Investment Return	3,489,492	1,169,679	-	4,659,171
Appropriation of endowment assets for expenditure	(8,457,193)	-	-	(8,457,193)
Endowment net assets, end of year	<u>\$ 23,432,485</u>	<u>\$ 5,342,791</u>	<u>\$ 5,486,792</u>	<u>\$ 34,262,068</u>

A summary of endowment fund balances by type of fund as of September 30, 2016, is as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment	\$ -	\$ 4,173,112	\$ 5,486,792	\$ 9,659,904
Board-designated endowment	28,400,186	-	-	28,400,186
Endowment net assets, end of year	<u>\$ 28,400,186</u>	<u>\$ 4,173,112</u>	<u>\$ 5,486,792</u>	<u>\$ 38,060,090</u>

Changes in endowment net assets for the year ended September 30, 2016, are as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ 29,506,336	\$ 4,617,494	\$ 5,486,792	\$ 39,610,622
Investment Return:				
Investment income	195,025	66,565	-	261,590
Realized gains on investments	404,715	138,134	-	542,849
Unrealized gains on investments	839,878	286,661	-	1,126,539
Total Investment Return	1,439,618	491,360	-	1,930,978
Appropriation of endowment assets for expenditure	(2,545,768)	(935,742)	-	(3,481,510)
Endowment net assets, end of year	<u>\$ 28,400,186</u>	<u>\$ 4,173,112</u>	<u>\$ 5,486,792</u>	<u>\$ 38,060,090</u>

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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 commitments under the lease are as follows:

<u>Years Ending September 30,</u>	
2018	\$ 260,864
2019	268,690
2020	<u>206,018</u>
	<u>\$ 735,572</u>

Rent expense for the years ended September 30, 2017 and 2016 was approximately \$731,000 and \$491,000, respectively.

In April 2016, HMRI entered into a sale and leaseback agreement for a property used as HMRI's main office and research facility. Under this agreement, HMRI is not required to make lease payments until March 2018. Consequently, HMRI recorded \$480,200 and 240,000 of in-kind rent expense and in-kind contributions for the years ended September 30, 2017 and 2016, respectively. The lease is renewable and requires monthly payments after the initial 24-month period. However, HMRI does not intend to renew the lease and plans to move to a new location before March 2018 (Note 8). For the year ending September 30, 2016, sale proceeds of \$5,961,778 are designated by the Board for capital expenditures and are included in cash designated for capital expenditures and net assets designated by the Board in the accompanying statement of financial position. Gain from sale totaling \$5,494,608 is included in the accompanying statement of activities and changes in net assets as gain on disposal of fixed assets.

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, 2017 and 2016, HMRI's unfunded commitments to these limited partnerships were \$499,000 and \$731,500, respectively.

Note 18 – Subsequent Events

Management has evaluated subsequent events through May 9, 2018, the date the financial statements were available to be issued.