The Scripps Research Institute

Financial Statements as of and for the
Years Ended September 30, 2014 and 2013,
and Independent Auditors' Report

THE SCRIPPS RESEARCH INSTITUTE

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THE SCRIPPS RESEARCH INSTITUTE

MANAGEMENT'S STATEMENT ON RESPONSIBILITY FOR ACCOUNTING AND FINANCIAL REPORTING

Management has the primary responsibility for the preparation of the financial statements and for ascertaining that the financial statements and other information fairly reflect the financial position and results of operations of The Scripps Research Institute.

The financial statements were prepared in accordance with accounting principles generally accepted in the United States of America and necessarily include amounts that are based on best estimates and judgments with appropriate consideration given to materiality. Management has made these estimates and judgments based on extensive experience and a substantive understanding of the underlying events and transactions.

In fulfilling its responsibility for the reliability and integrity of financial information, management has established and maintains accounting procedures and related internal control systems. Management believes that these systems and controls provide reasonable assurance that assets are safeguarded, that transactions are executed in accordance with management's authorizations and properly recorded to permit the preparation of reliable financial statements in conformity with accounting principles generally accepted in the United States of America, and that material errors or irregularities are either prevented or detected within a timely manner by employees in the normal course of performing their assigned duties. The Scripps Research Institute's independent auditors consider the established internal control systems to the extent necessary to express an opinion on the financial statements.

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INDEPENDENT AUDITORS' REPORT

To The Board of Trustees
The Scripps Research Institute:

Report on the Financial Statements

We have audited the accompanying financial statements of The Scripps Research Institute (the "Institute"), which comprise the balance sheets as of September 30, 2014 and 2013, and the related statements of activities and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 audits. We conducted our audits 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 Institute'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 the Institute as of September 30, 2014 and 2013, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

December 18, 2014

THE SCRIPPS RESEARCH INSTITUTE

BALANCE SHEETS
AS OF SEPTEMBER 30, 2014 AND 2013
(In thousands)

	2014	2013
ASSETS		
CASH AND CASH EQUIVALENTS	$ 17,930	$ 17,619
GRANTS AND CONTRACTS	43,290	51,265
OTHER ASSETS AND RECEIVABLES — Net	15,033	17,492
INVESTMENTS	421,232	437,391
PROPERTY — Net	349,043	359,347
TOTAL	$ 846,528	$ 883,114
LIABILITIES AND NET ASSETS		
ACCOUNTS PAYABLE AND ACCRUED EXPENSES	$ 36,242	$ 39,941
DEFERRED REVENUE	29,012	30,605
DEBT	44,671	46,980
POSTRETIREMENT BENEFITS AND OTHER	39,949	38,114
Total liabilities	149,874	155,640
NET ASSETS:		
Unrestricted	448,955	462,609
Temporarily restricted	205,955	223,046
Permanently restricted	41,744	41,819
Total net assets	696,654	727,474
TOTAL	$ 846,528	$ 883,114

See notes to the financial statements.

THE SCRIPPS RESEARCH INSTITUTE

STATEMENTS OF ACTIVITIES
FOR THE YEARS ENDED SEPTEMBER 30, 2014 AND 2013
(In thousands)

	2014	2013
CHANGES IN UNRESTRICTED NET ASSETS:		
Revenue:		
Grants and contracts	$ 312,445	$ 320,212
Other revenue and support	15,182	16,055
Investment income	11,325	18,059
Net assets released from restrictions	38,610	35,884
Total revenue	377,562	390,210
Expenses:		
Research	343,627	357,117
Postgraduate and graduate education	22,214	22,554
Management and general	16,053	16,378
Other	4,337	3,850
Total expenses	386,231	399,899
DEFICIENCY OF REVENUES OVER EXPENSES	(8,669)	(9,689)
PENSION-RELATED CHANGES OTHER THAN NET PERIODIC PENSION EXPENSE	(4,985)	19,305
Changes in unrestricted net assets	(13,654)	9,616
CHANGES IN TEMPORARILY RESTRICTED NET ASSETS:		
Grants	300	4,700
Other support and contributions	3,977	6,335
Investment income	17,242	14,580
Net assets released from restrictions	(38,610)	(35,884)
Changes in temporarily restricted net assets	(17,091)	(10,269)
CHANGES IN PERMANENTLY RESTRICTED NET ASSETS — Contributions and other support	(75)	582
CHANGES IN NET ASSETS	(30,820)	(71)
NET ASSETS — Beginning of year	727,474	727,545
NET ASSETS — End of year	$ 696,654	$ 727,474

See notes to financial statements.

THE SCRIPPS RESEARCH INSTITUTE

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED SEPTEMBER 30, 2014 AND 2013
(In thousands)

	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Changes in net assets	$ (30,820)	$ (71)
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation and amortization	32,985	35,394
Loss on disposal of property	1,107	1,046
Realized and unrealized gain on investments	(18,356)	(23,551)
Contributions restricted for endowment	(285)	(209)
Pension-related changes other than net periodic pension costs	4,985	(19,305)
Changes in assets and liabilities:		
Grants and contracts	7,974	1,074
Other assets and receivables — net	2,459	(190)
Accounts payable and accrued expenses	(772)	(3,295)
Deferred revenue	(1,593)	(1,864)
Postretirement benefits and other	(3,150)	(2,568)
Net cash used in operating activities	(5,466)	(13,539)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investments	(249,791)	(38,183)
Proceeds from sales of investments	284,307	83,771
Property additions	(26,849)	(24,609)
Net cash provided by investing activities	7,667	20,979
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on debt	(2,175)	(2,065)
Contributions restricted for endowment	285	202
Net cash used in financing activities	(1,890)	(1,863)
NET INCREASE IN CASH AND CASH EQUIVALENTS	311	5,577
CASH AND CASH EQUIVALENTS — Beginning of year	17,619	12,042
CASH AND CASH EQUIVALENTS — End of year	$ 17,930	$ 17,619
SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Interest paid	$ 2,331	$ 2,410
Property additions included in accounts payable	$ 2,609	$ 5,537

See notes to financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General — The Scripps Research Institute (TSRI) conducts biomedical research in California and Florida funded primarily with grants from agencies of the United States government. TSRI is a California not-for-profit public benefit corporation, exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code. A significant reduction in funding from U.S. government agencies could have a material impact on the operations and cash flows of TSRI.

TSRI also operates a graduate school known as The Kellogg School of Science and Technology ("The Kellogg School"). Accredited by the Western Association of Schools and Colleges, The Kellogg School provides an interdisciplinary program in the chemical and biological sciences and confers the degrees of Doctor of Philosophy, Doctor of Philosophy — Honorary, and Master of Science.

Scripps Florida — Scripps Florida was established in January 2004 as an operating division of TSRI. Using the latest technology, scientists at Scripps Florida focus on basic biomedical research and drug discovery. In addition to resources provided by the National Institutes of Health and other grantors, funding is also provided by a grant of $310 million, plus interest, from the State of Florida. At September 30, 2014, the entire grant was awarded and distributed.

In February 2006, the County of Palm Beach (the "County") voted to provide Scripps Florida with permanent facilities on a campus that includes a 30-acre site on the Jupiter campus of Florida Atlantic University (FAU) and 70 acres on the parcel (the "Briger parcel") located across the street from FAU. The County grant agreement for the permanent facilities includes: (i) a 99-year sublease for the FAU land, (ii) $187 million in funding for construction of the permanent facilities on the FAU land, and (iii) an option to enter into a lease for the Briger parcel. Occupancy of the permanent facility, and depreciation, commenced on March 31, 2009. The lease for the Briger parcel was signed by TSRI and the County on January 24, 2012, and expires on February 6, 2021, after which the County is required to convey fee simple title to TSRI. The $23 million appraised value of the grant for the use of the Briger property as of the date of the lease, is reflected as land and temporarily restricted revenue and is being amortized into unrestricted revenue over the term of the lease. The $13 million grant for the use of the underlying FAU land is being amortized as unrestricted revenue ratably over the life of the lease.

Basis of Presentation — TSRI's net assets and its revenues, gains, and losses are classified based on the existence, or absence, of donor-imposed restrictions. Accordingly, net assets and changes therein are classified and reported as follows:

Unrestricted Net Assets — Unrestricted net assets are not subject to donor-imposed or other restrictions and include the carrying value of all land, buildings, investments and equipment. Items that affect this category consist of unrestricted gifts, plus revenue and expenses associated with the primary objectives of TSRI, and releases of temporarily restricted net assets as described below. Unspent grant funds from federal and other grantors received in advance of the related expenditure are reported as deferred revenue.

Temporarily Restricted Net Assets — Temporarily restricted net assets result from amounts designated by donors for use in future periods, generally for specific research projects. Expirations of temporary restrictions are reported as net assets released from restrictions upon appropriation or upon the expiration of the restriction period. Gifts of cash for the acquisition of property are reported as net assets released from restriction when the property is placed in service. Restricted amounts whose restrictions are met in the same reporting period are reported as increases to temporarily restricted net assets with a corresponding release from restriction.

Permanently Restricted Net Assets — Permanently restricted net assets include donor-restricted gifts and bequests for permanent projects.

Unconditional pledges are recorded at their estimated present value reduced by an allowance for uncollectible amounts.

Technology Licensing Agreements — The transfer of research results into the commercial marketplace is a fundamental component of TSRI's research activities. Accordingly, TSRI is a party to various arrangements that generally provide for the licensing of technology developed at TSRI's California and Florida campuses in exchange for research funding, royalties, other compensation, or ownership participation. In arrangements that contain multiple elements, the revenue allocation is based on each element's relative fair value provided that (i) each element meets the criteria as a separate unit of accounting, (ii) the element has value to the customer on a stand-alone basis, and (iii) there is objective and verifiable evidence of the fair value of the separate elements. The total value of the arrangement is recognized either ratably over the period of the transaction or as amounts are expended if the fair value of each element cannot be objectively determined.

The Patent and Trademark Law Amendments Act of 1980 as amended, more commonly known as the Bayh-Dole Act, requires that academic institutions share with the inventor(s) a portion of any revenue received from the licensing of an invention. The requirements of this act result in royalty-sharing arrangements between TSRI and its faculty, some of whom may be related parties.

Cash and Cash Equivalents — Liquid investments, which fund the daily operating activities of TSRI and have a maturity of three months or less at the time of purchase, are reported as cash and cash equivalents.

Investments — Investments are carried at fair value, which is generally determined by management based on quoted market prices provided by independent outside valuation services.

Investments for which readily determinable market values do not exist are recorded at estimated fair value as determined by TSRI, with the assistance of fund managers, the general partners, or third-party service providers, using methods and assumptions TSRI considers appropriate based on its understanding of the underlying characteristics of the investments.

Investment securities, in general, are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of volatility associated with certain investment securities, it is probable that changes in the values of investment securities will occur from time to time and that such changes could materially affect the amounts reported in the accompanying balance sheets.

Use of Estimates and Assumptions — The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the amounts of revenues and expenses, and the related financial statement disclosures. Actual results could differ from those estimates.

Subsequent Events — In accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 855, *Subsequent Events*, TSRI evaluated subsequent events through December 18, 2014, the date of the release of these financial statements.

2. INVESTMENTS

General — TSRI's investment portfolio includes cash, marketable securities, and nonmarketable securities managed by independent professional investment managers. Certain of these managers are authorized to invest a limited portion of TSRI's portfolio in derivative instruments to increase portfolio diversification and return and to reduce volatility.

Investments at fair value as of September 30, 2014 and 2013, are summarized as follows (in thousands):

	2014	2013
Cash and short-term investment funds	$ 147,685	$ 142,183
Growth assets:		
Global equity and convertible securities	123,736	139,833
Directional hedge funds	50,325	42,442
Private equity LPs	27,335	26,144
Inflation protection assets:		
Private real estate LPs	8,636	10,572
Private oil and gas LPs	6,881	9,143
Risk reduction assets:		
Government, mortgage, and corporate debt funds	32,151	48,282
Absolute return strategy funds	24,483	18,792
Total	$ 421,232	$ 437,391

Investments with a fair value of $5.3 million and $5.2 million at September 30, 2014 and 2013, respectively, included above, have been received under annuity and unitrust agreements, which require annual payments from the trust to the beneficiaries during their lifetimes. Upon the death of the beneficiaries, substantially all of the remaining assets are available for general purposes, unless restricted. The liability to such beneficiaries of $1.1 million and $1.3 million at September 30, 2014 and 2013, is based on life expectancies and the annual payment required, discounted at the risk-free interest rate of 6% for 2014 and 2013, respectively.

Unspent grant funds restricted to support the Florida division totaled $91.1 million and $108.7 million at September 30, 2014 and 2013, respectively. The majority of these unspent funds are invested through a mutual fund in short-term, fixed-income obligations with maturities of up to one year.

The composition of investment income for the years ended September 30, 2014 and 2013, includes the following (in thousands):

	2014	2013
Interest and dividends:		
Unrestricted	$ 3,893	$ 4,594
Temporarily restricted	5,902	4,774
Permanently restricted	56	100
Net gains:		
Unrestricted	7,432	13,465
Temporarily restricted	11,340	9,806
Permanently restricted	(416)	280
Investment income — net	$ 28,207	$ 33,019

Fair Value — Assets and liabilities recorded at fair value have been categorized based upon a fair value hierarchy in accordance with FASB ASC 820, *Fair Value Measurements and Disclosures*. Level 1 inputs utilize quoted prices in active markets for identical assets or liabilities. Level 2 inputs are based on other observable market data, such as quoted prices for similar assets and liabilities, and inputs other than quoted prices that are observable, such as interest rates and yield curves. Level 3 inputs are developed from unobservable data reflecting management's own assumptions and include situations where there is little or no market activity for the asset or liability.

The following is a general description of the valuation methodologies used for financial assets and liabilities measured at fair value, including the general classification of such assets and liabilities pursuant to the valuation hierarchy:

Marketable Securities — Utilizing Level 1 inputs include listed equity and bond market mutual funds, and exchange-traded equity securities held in professionally managed separate accounts, with valuation based upon quoted prices in active markets.

Nonmarketable Securities — Utilizing Level 2 inputs include shares in funds, such as unlisted mutual funds, limited exempted corporations, limited partnerships (LPs), and common trust funds (collectively, "commingled funds"). Commingled funds have a net asset value (NAV) determined by market corroborated pricing or other models using observable inputs and are invested by professional asset management firms in the global equity, convertible, and fixed-income securities markets. In almost all cases, the individual securities held in commingled funds have readily determinable market values and provide daily or monthly liquidity. TSRI's investment in these vehicles may not be equal to the ratable portion of market values of those securities.

A portion of TSRI's nonmarketable securities, including directional hedge funds, absolute return strategy funds, and private equity, real estate, and oil and gas LPs, (collectively, "alternative investments"), has been classified as utilizing Level 3 inputs since valuation requires substantial judgment and estimation of factors not currently observable in the market. Alternative investments consist of fund holdings with varying redemption terms and conditions and are valued at TSRI's pro rata allocation of the fund's NAV or LP's equity balance, as determined by the fund's investment manager or general partner, respectively. Certain funds, structured as LPs, are illiquid, long-term commitments and are subject to future capital calls of $15.8 million and $21.0 million at September 30, 2014 and 2013, respectively.

Nonmarketable securities that meet all of the following criteria are classified as Level 2 under the fair value hierarchy:

- The notice period for redemption is 90 days or less
- No lock up is in effect
- A full redemption is available at a determination date
- No "gate" or other redemption restriction is in effect
- No right to suspend redemptions exists

Nonmarketable securities not meeting the above criteria are classified as Level 3.

Gift Annuities and Unitrusts — Obligations from donated assets are held by a bank custodian and subject to a payment schedule specified in the terms of the donor's agreement with TSRI. These assets have been classified as Level 1 as the fair value can be determined by quoted prices in active markets. TSRI's liabilities under the agreements with the donors calculated by utilizing interest rate and actuarial inputs have been classified as Level 2.

The assets and liabilities measured at fair value on a recurring basis as of September 30, 2014 and 2013, including the fair value hierarchy of the valuation techniques utilized to determine such fair value, are as follows (in thousands):

2014 **Assets**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Balance September 30, 2014**
Marketable securities:				
Cash and short-term investment funds	$124,012	$22,933	$ -	$146,945
Global equity and convertible securities	122,677			122,677
Government, mortgage, and corporate debt funds	28,684			28,684
Total marketable securities	275,373	22,933	-	298,306
Nonmarketable securities:				
Directional hedge funds			50,325	50,325
Private real estate LPs			8,636	8,636
Private equity LPs			27,335	27,335
Private oil and gas LPs			6,881	6,881
Absolute return strategy funds			24,483	24,483
Total nonmarketable securities	-	-	117,660	117,660
Gift annuities and unitrusts:				
Cash and short-term investment funds	739			739
Global equity and convertible securities	1,059			1,059
Government, mortgage, and corporate debt funds	3,468			3,468
Total gift annuities and unitrusts	5,266	-	-	5,266
Total	$280,639	$22,933	$117,660	$421,232
Liabilities				
Gift annuities and unitrusts		$ 1,121		$ 1,121

2013 Assets	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance September 30, 2013
Marketable securities:				
Cash and short-term investment funds	$137,243	$ 4,300	$ -	$141,543
Global equity and convertible securities	112,298			112,298
Government, mortgage, and corporate debt funds	30,759	14,143		44,902
Total marketable securities	280,300	18,443	-	298,743
Nonmarketable securities:				
Directional hedge funds			42,443	42,443
Private real estate LPs			10,572	10,572
Private equity LPs			26,144	26,144
Private oil and gas LPs			9,143	9,143
Absolute return strategy funds			18,792	18,792
Global equity and convertible securities		26,398		26,398
Total nonmarketable securities	-	26,398	107,094	133,492
Gift annuities and unitrusts:				
Cash and short-term investment funds	640			640
Global equity and convertible securities	1,136			1,136
Government, mortgage, and corporate debt funds	3,380			3,380
Total gift annuities and unitrusts	5,156	-	-	5,156
Total	$285,456	$44,841	$107,094	$437,391
Liabilities				
Gift annuities and unitrusts		$ 1,273		$ 1,273

There were no significant transfers between Level 1 and Level 2 of the fair value hierarchy for the years ended September 30, 2014 and 2013. The changes in Level 3 instruments measured on a recurring basis for the years ended September 30, 2014 and 2013, are as follows (in thousands):

Balance — September 30, 2012	$ 100,302
Transfers into (out of) Level 3	
Net realized and unrealized gains	5,156
Purchases	9,486
Settlements	(7,850)
Balance — September 30, 2013	107,094
Transfers into (out of) Level 3	
Net realized and unrealized gains	4,301
Purchases	31,499
Settlements	(25,234)
Balance — September 30, 2014	$ 117,660

Gains and losses (realized and unrealized) for the periods above are reported in investment income in the unrestricted and temporarily restricted sections, and in contributions and other support in the permanently restricted section of the accompanying statements of activities.

Investments for which market quotations are not readily available, may be valued using the stated NAV, which is known as using the practical expedient method to estimate the fair value of investment under ASC 820 and Accounting Standards Update (ASU) No. 2009-12. A summary of investments with a reported NAV as of September 30, 2014 and 2013, is as follows (in thousands):

	Fair Value Estimated Using NAV per Share September 30, 2014				
Investment	**Fair Value ***	**Unfunded Commitment**	**Redemption Frequency**	**Other Redemption Restrictions**	**Redemption Notice Period**
Short term investment funds (a)	$ 22,933	$ -	Monthly		<31 days
Alternative investment funds — Nonmarketable:					
Directional hedge funds (b)	50,325		Quarterly: 2-year rolling		30–90 days
Private equity real estate LPs (b)	8,636	1,842	N/A	Not eligible for redemption	N/A
Private equity LPs (b)	27,335	10,632	N/A	Not eligible for redemption	N/A
Private oil and gas LPs (b)	6,881	3,325	N/A	Not eligible for redemption	N/A
Absolute return strategy funds (b)	24,483		Quarterly — annual		45–60 days
Total	$140,593	$15,799			

	Fair Value Estimated Using NAV per Share September 30, 2013				
Investment	**Fair Value ***	**Unfunded Commitment**	**Redemption Frequency**	**Other Redemption Restrictions**	**Redemption Notice Period**
Commingled funds — Nonmarketable:					
Global equity and convertible securities (a)	$ 26,398	$ -	Monthly		<31 days
Government, mortgage, and corporate debt (a)	18,443		Monthly		<31 days
Alternative investment funds — Nonmarketable:					
Directional hedge funds (b)	42,443		Quarterly: 2-Year Rolling		30–90 days
Private equity real estate LPs (b)	10,572	2,867	N/A	Not eligible for redemption	N/A
Private equity LPs (b)	26,144	13,130	N/A	Not eligible for redemption	N/A
Private oil and gas LPs (b)	9,143	5,005	N/A	Not eligible for redemption	N/A
Absolute return strategy funds (b)	18,792		Quarterly–Annual		45–60 days
Total	$151,935	$21,002			

* The fair values of investments have been estimated using the NAV of the investment.

(a) Commingled Funds — Interests in units/shares of these funds do not trade in active markets; however, managers are restricted by their investment mandates to investing in common stock, real estate investment trusts, and fixed-income securities. Fair value is primarily determined by aggregating the close of market prices of such securities, which are observable market inputs. Although the funds have other assets and liabilities, such as foreign currency hedges, securities lending collateral and receivables and payables, these generally comprise a small portion of total assets of NAV.

(b) Alternative Investment Funds — Interests in units/shares of these funds do not trade in active markets. For directional hedge funds and absolute return strategy funds, fair value is determined based upon a combination of readily observable market prices, third-party pricing sources, and discounted cash flow and other valuation models. For direct partnership investments in private equity, real estate, and oil and gas LPs, fair value is determined based upon discounted cash flow or other valuation models. For fund-of-funds partnership investments in private equity LPs, fair value is based upon a review of underlying fund investments, as reported by individual managers.

Endowment — TSRI’s endowment consists of approximately 69 individual funds established for various purposes, including both donor-restricted funds and funds designated by the Board to function as endowments. As required by generally accepted accounting principles, net assets associated with endowment funds, including funds designated by the Board to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

TSRI's Board intends to preserve 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. As a result, TSRI 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 as permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure in a prudent manner. TSRI considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- The duration and preservation of the fund
- The purposes of the organization and the donor-restricted endowment fund
- General economic conditions
- The possible effect of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other resources of the organization
- The investment policies of the organization

TSRI has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity or for donor-specified periods. Under this policy, as approved by the Board, the endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results of a customized index while assuming a moderate level of investment risk. To satisfy its long-term investment return objectives, TSRI relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). TSRI targets a diversified asset allocation that places a greater emphasis on equity or equity-like investments to achieve its long-term return objectives within prudent risk constraints.

TSRI expects its endowment funds over time to provide an average annual rate of return of approximately the consumer price index (CPI), plus 5%, net of fees. Actual returns in any given year may vary from this amount. Each year, TSRI appropriates for expenditure 5% of the endowment fund's average fair value for the 12 quarters approximately preceding May 31 in the fiscal year before which the distribution is planned. In establishing this policy, TSRI considered the long-term expected return on its endowment. Over the long term, TSRI expects the current spending policy to allow its endowment to grow at the inflation rate expressed as the change in the CPI. This is consistent with TSRI's objective to maintain the purchasing power of endowment assets held in perpetuity or for a specified term as well as to provide additional growth through new gifts and investment return.

Net Assets — Temporarily restricted net assets as of September 30, 2014 and 2013, include net assets restricted for use in future periods or for designated research purposes as follows (in thousands):

	2014	2013
Restricted for future periods	$ 77,351	$ 74,660
Restricted for research purposes	128,604	148,386
Total	$ 205,955	$ 223,046

Net assets released from donor restriction by the satisfaction of time restrictions or by incurring expenses satisfying the restricted purposes during the years ended September 30, 2014 and 2013, are as follows (in thousands):

	2014	2013
Satisfaction of time restrictions	$ 7,367	$ 6,483
Purpose restrictions — research	31,243	29,401
Total net assets released from restrictions	$ 38,610	$ 35,884

The endowment net assets' composition by type of fund as of September 30, 2014 and 2013, is as follows (in thousands):

2014	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds and net appreciation	$ -	$ 74,965	$ 41,744	$ 116,709
Board-designated endowment funds	23,898			23,898
Total funds	$ 23,898	$ 74,965	$ 41,744	$ 140,607
2013				
Donor-restricted endowment funds and net appreciation	$ -	$ 70,604	$ 41,819	$ 112,423
Board-designated endowment funds	23,330			23,330
Total funds	$ 23,330	$ 70,604	$ 41,819	$ 135,753

The changes in endowment net assets as of September 30, 2014 and 2013, are as follows (in thousands):

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets — September 30, 2012	$ 22,178	$ 65,703	$ 41,237	$129,118
Investment income	244	1,544	100	1,888
Realized and unrealized gains	1,530	6,997	280	8,807
Contributions			252	252
Appropriation of endowment assets for expenditure	(622)	(3,640)		(4,262)
Other changes — unitrust disbursements			(50)	(50)
Endowment net assets — September 30, 2013	23,330	70,604	41,819	135,753
Investment income	310	2,899	56	3,265
Realized and unrealized gains	1,729	6,796	(416)	8,109
Contributions			323	323
Appropriation of endowment assets for expenditure	(1,471)	(5,334)		(6,805)
Other changes — unitrust disbursements			(38)	(38)
Endowment net assets — September 30, 2014	$ 23,898	$ 74,965	$ 41,744	$140,607

The description of the amounts classified as restricted net assets as of September 30, 2014 and 2013, are as follows (in thousands):

	2014	2013
Permanently restricted net assets — the portion of perpetual endowment funds that is required to be retained permanently either by explicit donor stipulation or by FASB ASC 958	$ 41,744	$ 41,819
Temporarily restricted net assets — the portion of perpetual endowment funds subject to a time restriction under FASB ASC 958	$ 74,965	$ 70,604

3. PLEDGES RECEIVABLE — NET

Pledges receivable — net as of September 30, 2014 and 2013, included in other assets and receivables in the accompanying balance sheets, are summarized as follows (in thousands):

	2014	2013
Pledges receivable — restricted to future periods — net:		
Unconditional promises to give	$ 3,716	$ 4,555
Less unamortized discount	(320)	(390)
Subtotal	3,396	4,165
Less allowance for uncollectibles	(1,011)	(110)
Total	$ 2,385	$ 4,055
Amounts due in:		
Less than one year	$ 698	$ 550
One to five years	2,486	3,423
More than five years	532	582
Total	$ 3,716	$ 4,555

Discount rates ranged from 0.3% to 5.25% for 2013 and 2014.

4. PROPERTY

Property as of September 30, 2014 and 2013, is summarized as follows (in thousands):

	2014	2013
Land	$ 42,646	$ 42,646
Buildings	426,095	420,466
Equipment	258,150	255,489
Other assets	4,029	4,510
Total property	730,920	723,111
Less accumulated depreciation and amortization	(381,877)	(363,764)
Property — net	$ 349,043	$ 359,347

The estimated useful lives of building and equipment spans up to 35 years.

5. DEBT

TSRI borrows money through the issuance of tax-exempt and taxable debt pursuant to a Master Indenture of Trust entered into in 1994. The 1994 Master Indenture of Trust contains certain covenants, including limitations on the incurrence of additional debt. TSRI was in compliance with those covenants at September 30, 2014 and 2013.

In 2000, TSRI borrowed $16 million through the issuance of tax-exempt serial and term bonds sponsored by the California Infrastructure and Economic Development Bank. Principal is due in varying annual installments through 2030. Interest is payable on a semiannual basis at rates ranging from 4.80% to 5.75%. These bonds are collateralized by a pledge of revenues.

In 2005, TSRI borrowed $44.5 million, which included $36.3 million in tax-exempt debt and $8.2 million in taxable debt, in serial and term bonds sponsored by the California Infrastructure and Economic Development Bank. These bonds are collateralized by a pledge of revenues. Principal is due in varying annual installments through 2029. Interest is payable on a semiannual basis at rates ranging from 5.00% to 5.04%. Approximately $22 million of this debt was issued to redeem the 1994 debt issue. At September 30, 2014 and 2013, the unamortized original issue premium on the 2005 bonds was $2 million and $2.1 million, respectively.

Interest paid in fiscal years 2014 and 2013 on long-term debt was $2.3 million and $2.4 million, respectively. The estimated fair value of the tax-exempt bonds, calculated using market observable interest rates (Level 2 inputs) was $44.7 million and $46.9 million at September 30, 2014 and 2013, respectively.

Scheduled principal repayments on long-term debt as of September 30, 2014, are as follows (in thousands):

Years Ending September 30	
2015	$ 2,280
2016	2,400
2017	2,525
2018	2,660
2019	2,210
Thereafter	30,615
Total	$ 42,690

6. POSTRETIREMENT BENEFITS AND OTHER

Postretirement benefits and other as of September 30, 2014 and 2013, include benefit obligations as follows (in thousands):

	2014	**2013**
Defined benefit plan	$ 23,808	$ 18,823
Deferred compensation and other	7,561	6,539
Total postretirement benefits	$ 31,369	$ 25,362

Defined Benefit Plan — Eligible TSRI employees who were not covered by the TSRI Faculty and Management Retirement Plan were covered by a defined benefit plan (the TSRI Cash Balance Retirement Plan). Pension benefits under the plan were based on specified benefit amounts and years of service. TSRI funds the pension liability, through contributions to an independent trust, at an amount equal to the net periodic pension expense.

In September 2013, TSRI amended the plan to cease the accrual of additional benefits effective December 31, 2013. This amendment resulted in a curtailment, which decreased the 2013 Post Retirement and Other liability and decreased Pension Related Changes Other Than Net Periodic Pension Expense by $3.8 million. Active plan participants receive employer contributions, determined as a percentage of participant salary, in the new TSRI Employment Retirement Plan, which totaled $2 million for the year ended September 30, 2014.

Deferred Compensation and other — TSRI has a deferred compensation plan for certain employees. Generally, this plan offers a deferred compensation benefit equal to 25% of base compensation accrued each month during the course of employment. The benefits are payable in a lump sum following the earlier of: i) separation from service or departure from TSRI; ii) death; or iii) permanent disability.

Defined Contribution Plans — TSRI provides a noncontributory money purchase plan for scientific staff and management (the TSRI Faculty and Management Retirement Plan). Contributions under this plan, determined as a percentage of participant salary, were $8.6 million and $6.8 million for the years ended September 30, 2014, and 2013, respectively.

Employees who were eligible to participate in the TSRI Cash Balance Retirement Plan, or its new replacement defined contribution plan (the TSRI Employment Retirement Plan), also receive an employer matching contribution into a Tax Sheltered Annuity Plan of 50% of the employee contribution up to 6% of compensation. TSRI contributions to the Tax-Sheltered Annuity Plan were $779,000 and $684,000 for the years ended September 30, 2014 and 2013, respectively.

A summary of the changes in the benefit obligation and Plan assets at September 30, 2014 and 2013, is presented below (in thousands):

	2014	2013
Change in projected benefit obligation (PBO):		
PBO at prior measurement date	$ 73,721	$ 87,731
Service cost	1,057	4,166
Interest cost	3,760	3,648
Actuarial loss (gain)	10,098	(12,688)
Benefits paid	(5,327)	(5,032)
Curtailments		(3,800)
Administrative expenses paid	(370)	(304)
PBO at current measurement date	$ 82,939	$ 73,721
Change in plan assets:		
Fair value of assets at prior measurement date	$ 54,898	$ 49,603
Actual gain on assets	7,194	3,082
Employer contributions	2,736	7,549
Benefits paid	(5,327)	(5,032)
Administrative expenses paid	(370)	(304)
Fair value of assets at current measurement date	$ 59,131	$ 54,898
Components of net periodic pension expense:		
Service cost	$ 1,057	$ 4,166
Interest cost	3,760	3,648
Expected return on assets	(3,749)	(4,012)
Amortization of prior service cost		120
Curtailments		(16)
Net gain amortization	1,668	3,627
Net periodic pension expense	$ 2,736	$ 7,533

Assuming no further significant changes in the Plan's design or valuation assumptions, net periodic pension expense for the year ended September 30, 2015, is approximately $2.8 million. The amortization of net loss and net prior service cost for the year ended September 30, 2015, is $2.6 million.

A reconciliation of the funded status of the Plan at September 30, 2014 and 2013, is as follows (in thousands):

	2014	2013
Accumulated benefit obligation	$ (82,939)	$ (73,646)
Projected benefit obligation	$ (82,939)	$ (73,721)
Fair value of assets	59,131	54,898
Funded status	$ (23,808)	$ (18,823)

Assumptions used to determine the projected benefit obligation for the years ended September 30, 2014 and 2013, are as follows:

	2014	**2013**
Discount rate	4.5 %	5.3 %
Compensation increase rate		3.0
Measurement date — September 30	2014	2013
Census date — January 1	2014	2013

Assumptions used to determine expense for the years ended September 30, 2014 and 2013, are as follows:

	2014	**2013**
Discount rate	5.3 %	4.3 %
Long-term rate of return on assets	6.8	7.5
Compensation increase rate	3.0	3.0

Expected benefit payments as of September 30, 2014, are as follows (in thousands):

Years Ending September 30	
2015	$ 4,884
2016	4,714
2017	4,719
2018	4,519
2019	4,672
Thereafter through 2023	22,626

The Investment Committee of the Board is responsible for the safety of the invested assets of the Plan through (i) the identification, adoption, and maintenance of an appropriate asset allocation that provides a target for the asset class within a minimum and maximum range; (ii) the identification, adoption, and maintenance of appropriate investment guidelines, policies, and procedures; and (iii) performance monitoring of portfolio managers against expectations as set forth in the investment guidelines. The policies are intended to provide for safety of principal through diversification in portfolios of domestic and international common stocks, bonds, LP interests, and cash equivalents at return objectives consistent with the risk levels established by the Board. The equity portion of the portfolio is diversified by economic sector, industry, quality, and size and is invested at the discretion of managers with distinct investment styles and specific guidelines. The allocation to absolute return strategies is invested in a multistrategy hedge “fund-of-funds” LP. The allocation to private equity is invested in fund-of-funds LPs, including a mix of venture capital, buyout, and distressed debt. Real assets consist of global real estate mutual funds. Professional investment advisors manage Plan investments.

An independent Outsourced Chief Investment Office recommends alternative diversification models, provides professional performance evaluation, selects investment managers, and estimates the long-term rate of return for the asset allocation in place. The return is based on weighted-average capital market assumptions, including historical returns and the standard deviation and correlation of those historical returns, adjusted to anticipate the effects of inflation and economic market conditions for each asset class in the Plan.

The Plan invests in mutual funds, common collective trust funds, commingled funds, and LPs. Plan assets include securities whose values are subject to fluctuations in the securities market. Changes in the fair value of these assets attributable to differences between actual and assumed returns are deferred as unrecognized gains or losses and included in the determination of net pension expense over time. Fair value is determined by quoted market prices for the same or similar instruments, except for absolute return strategy LPs and private equity fund LPs, which require substantial judgment and estimation of factors not currently observable in the market.

In accordance with FASB ASC 715-20-50, *Employers' Disclosures about Postretirement Benefit Plan Assets*, the Plan assets measured at fair value on a recurring basis as of September 30, 2014 and 2013, including the fair value hierarchy of the valuation techniques utilized to determine such fair value are as follows (see Note 3 — Investments for a description) (in thousands):

Balance as of September 30, 2014	**Level 1**	**Level 2**	**Level 3**	**Total Assets 2014**	**% of Plan Assets 2014**	**% Target Allocation 2015**
Marketable securities:						
Cash and short-term funds	$ -	$ 378	$ -	$ 378	0.6 %	- %
Global equity and convertible securities	28,238			28,238	47.9	45
Real asset funds	600			600	1.0	6
Government, mortgage, and corporate debt funds				-		30
Total marketable securities	28,838	378	-	29,216	49.5	81
Nonmarketable securities:						
Directional hedge funds			5,125	5,125	8.6	9
Private equity LPs			4,675	4,675	7.9	6
Private oil and gas LPs			614	614	1.0	1
Absolute return strategy funds			1,937	1,937	3.3	3
Government, mortgage, and corporate debt funds		17,564		17,564	29.7	
Total nonmarketable securities	-	17,564	12,351	29,915	50.5	19
Total	$28,838	$17,942	$12,351	$59,131	100.0 %	100 %

Balance as of September 30, 2013	**Level 1**	**Level 2**	**Level 3**	**Total Assets 2013**	**% of Plan Assets 2013**	**% Target Allocation 2014**
Marketable securities:						
Cash and short-term funds	$ -	$ 952	$ -	$ 952	2 %	- %
Global equity and convertible securities	20,227			20,227	37	43
Real asset funds	1,718			1,718	3	8
Government, mortgage, and corporate debt funds	14,099	2,665		16,764	30	30
Total marketable securities	36,044	3,617	-	39,661	72	81
Nonmarketable securities:						
Private equity LPs			3,962	3,962	7	7
Absolute return strategy funds			6,127	6,127	12	12
Global equity and convertible securities		5,148		5,148	9	
Total nonmarketable securities	-	5,148	10,089	15,237	28	19
Total	$36,044	$8,765	$10,089	$54,898	100 %	100 %

There were no significant transfers between Level 1 and Level 2 of the fair value hierarchy for the years ended September 30, 2014 and 2013. The changes in Level 3 instruments measured on a recurring basis for the years ended September 30, 2014 and 2013, are as follows (in thousands):

Balance — September 30, 2012	$ 9,735
Transfers into (out of) Level 3	
Net realized and unrealized gains	(179)
Purchases	957
Settlements	(424)
Balance — September 30, 2013	10,089
Transfers into (out of) Level 3	
Net realized and unrealized gains	2,385
Purchases	5,691
Settlements	(5,814)
Balance — September 30, 2014	$ 12,351

A summary of the Plan's investments with a reported NAV as of September 30, 2014 and 2013, is as follows (in thousands):

	Fair Value Estimated Using NAV per Share September 30, 2014				
Investment	**Fair Value ***	**Unfunded Commitment**	**Redemption Frequency**	**Other Redemption Restrictions**	**Redemption Notice Period**
Common/collective trust funds and other:					
Cash and short-term funds (a)	$ 378	$ -	Daily		None
Government, mortgage and corporate debt funds (b)	17,564		Weekly		<31 days
Alternative investment funds:					
Absolute return strategy funds (b)	1,937		Semiannual		90 days
Directional hedge funds	5,125		Quarterly		60 days
Private oil and gas LPs (b)	614	549	N/A	Not eligible	N/A
Private equity LPs (b)	4,675	2,080	N/A	Not eligible	N/A
Total	$ 30,293	$ 2,629			

	Fair Value Estimated Using NAV per Share September 30, 2013				
Investment	**Fair Value ***	**Unfunded Commitment**	**Redemption Frequency**	**Other Redemption Restrictions**	**Redemption Notice Period**
Common/collective trust funds and other:					
Cash and short-term funds (a)	$ 952	$ -	Daily		None
Nonmarketable global equity and convertible securities (a)	2,158		Monthly		<31 days
Global equity and convertible securities (b)	2,990		Monthly		<31 days
Government, mortgage and corporate debt funds(b)	2,665		Monthly		<31 days
Alternative Investment funds:					
Absolute return strategy funds (b)	6,127		Semiannual		90 days
Private equity LPs (b)	3,962	3,761	N/A	Not eligible	N/A
Total	$ 18,854	$ 3,761			

* The fair values of the investments have been estimated using the NAV of the investment.

(a) Common/Collective Trust Funds — The Plan has units/shares in the funds that do not trade in active markets; however, managers of these funds are restricted by their investment mandates to investing in common stock, real estate investment trusts, and fixed-income securities. Fair value is primarily determined by aggregating the close of market prices of such securities, which are observable market inputs. Although the funds have other assets and liabilities, such as foreign currency hedges, securities lending collateral, receivables and payables, these generally comprise a small portion of total assets of NAV.

(b) Alternative Investment Funds — Interests in units/shares of these funds do not trade in active markets. For directional hedge funds and absolute return strategy funds, fair value is determined based upon a combination of readily observable market prices, third-party pricing sources, and discounted cash flow and other valuation models. For direct partnership investments in private equity and oil and gas LPs, fair value is determined based upon discounted cash flow or other valuation models. For fund-of-funds partnership investments in private equity LPs, fair value is based upon a review of underlying fund investments, as reported by individual managers.

7. COMMITMENTS AND CONTINGENCIES

Long-Term Leases — TSRI has entered into noncancelable operating lease agreements for buildings and equipment, expiring on various dates through 2019. Approximate minimum future rental payments required by these leases as of September 30, 2014, are summarized as follows (in thousands):

Years Ending September 30	
2015	$ 21,081
2016	21,010
2017	17,542
2018	16,944
2019	11,983
Total	$ 88,560

Rental expense for operating leases totaled $23.6 million for the years ended September 30, 2014 and 2013. The deferred rent liability on operating leases is included in postretirement benefits and other in the accompanying balance sheets and was $8.1 million and $10 million at September 30, 2014 and 2013, respectively. The receivable from third parties for scheduled rent increases was $7.2 million and $9 million at September 30, 2014 and 2013, respectively. This receivable is included in grants and contracts in the accompanying balance sheets.

Contingencies — TSRI is a party to certain legal and other actions arising in the ordinary course of business. While it is not possible to predict or determine the outcome of these actions, it is the opinion of management that these liabilities do not have a material impact on the financial statements.

8. RECENTLY ISSUED ACCOUNTING STANDARDS

The following summarizes noteworthy, recently issued accounting standards:

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers*. ASU No. 2014-09 outlines a single comprehensive model for entities to use in accounting for revenue from contracts with customers. This standard supersedes most other revenue recognition guidance, including industry-specific guidance. ASU No. 2014-09 is effective for accounting periods beginning after December 15, 2017. Management of TSRI is in the process of evaluating the impact that the adoption of ASU 2014-09 will have on the financial statements.

In August 2014, the FASB issued ASU No. 2014-15, *Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern*. This standard provides guidance on disclosing going-concern uncertainties in the financial statements. The standard requires management to perform interim and annual assessments of the entity's ability to continue as a going concern within one year of the issuance of the financial statements. ASU 2014-15 is effective for annual periods ending after December 31, 2016. Management of TSRI does not expect the adoption of ASU 2014-15 to have an impact on the financial statements.

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