The Scripps Research Institute

Financial Statements as of and for the
Year Ended September 30, 2016 and 2015, and
Independent Auditors’ Report

THE SCRIPPS RESEARCH INSTITUTE

TABLE OF CONTENTS

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, 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 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" or "TSRI"), which comprise the balance sheets as of September 30, 2016 and 2015, 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, 2016 and 2015, 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 20, 2016

THE SCRIPPS RESEARCH INSTITUTE

BALANCE SHEETS
AS OF SEPTEMBER 30, 2016 AND 2015
(In thousands)

	2016	2015
ASSETS		
CASH AND CASH EQUIVALENTS	$ 14,020	$ 23,680
GRANTS AND CONTRACTS	56,742	50,456
OTHER ASSETS AND RECEIVABLES—Net	27,660	13,425
INVESTMENTS	376,399	379,576
PROPERTY—Net	320,822	336,197
TOTAL	$795,643	$803,334
LIABILITIES AND NET ASSETS		
ACCOUNTS PAYABLE AND ACCRUED EXPENSES	$ 34,401	$ 40,877
DEFERRED REVENUE	27,551	33,090
DEBT	55,905	42,256
POSTRETIREMENT BENEFITS AND OTHER	40,785	39,921
Total liabilities	158,642	156,144
NET ASSETS:		
Unrestricted	409,912	429,856
Temporarily restricted	176,689	170,447
Permanently restricted	50,400	46,887
Total net assets	637,001	647,190
TOTAL	$795,643	$803,334

See notes to financial statements.

THE SCRIPPS RESEARCH INSTITUTE

STATEMENTS OF ACTIVITIES
FOR THE YEARS ENDED SEPTEMBER 30, 2016 AND 2015
(In thousands)

	2016	2015
CHANGES IN UNRESTRICTED NET ASSETS:		
Revenue:		
Grants and contracts	$289,377	$301,659
Other revenue and support	12,118	30,118
Investment income (loss)	14,214	(3,244)
Net assets released from restrictions	31,822	37,693
Total revenue	347,531	366,226
Expenses:		
Research	324,755	343,694
Postgraduate and graduate education	20,505	21,650
Management and general	15,297	14,652
Other	4,113	4,165
Total expenses	364,670	384,161
DEFICIENCY OF REVENUES OVER EXPENSES	(17,139)	(17,935)
PENSION-RELATED CHANGES OTHER THAN NET PERIODIC PENSION EXPENSE	(2,805)	(1,164)
Changes in unrestricted net assets	(19,944)	(19,099)
CHANGES IN TEMPORARILY RESTRICTED NET ASSETS:		
Other support and contributions	28,931	5,638
Investment income (loss)	9,133	(3,453)
Net assets released from restrictions	(31,822)	(37,693)
Changes in temporarily restricted net assets	6,242	(35,508)
CHANGES IN PERMANENTLY RESTRICTED NET ASSETS—Contributions and other support	3,513	5,143
CHANGES IN NET ASSETS	(10,189)	(49,464)
NET ASSETS—Beginning of year	647,190	696,654
NET ASSETS—End of year	$637,001	$647,190

See notes to financial statements.

THE SCRIPPS RESEARCH INSTITUTE

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED SEPTEMBER 30, 2016 AND 2015
(In thousands)

	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES:		
Changes in net assets	$ (10,189)	$ (49,464)
Adjustments to reconcile changes in net assets to net cash used in operating activities:		
Depreciation and amortization	30,445	32,315
Loss on disposal of property	1,446	1,350
Net realized and unrealized (gain) loss on investments	(16,772)	14,097
Contributions restricted for endowment	(3,513)	(5,857)
Pension-related changes other than net periodic pension expense	2,805	1,164
Changes in assets and liabilities:		
Grants and contracts	(6,287)	(7,166)
Other assets and receivables—net	(13,141)	1,607
Accounts payable and accrued expenses	(5,530)	3,831
Deferred revenue	(5,539)	4,078
Postretirement benefits and other	(1,941)	(1,192)
Net cash used in operating activities	(28,216)	(5,237)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investments	(39,752)	(73,378)
Proceeds from sales of investments	59,702	100,938
Property additions	(19,360)	(20,150)
Net cash provided by investing activities	590	7,410
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on debt	(40,410)	(2,280)
Issuance of new debt	54,863	
Contributions restricted for endowment	3,513	5,857
Net cash provided by financing activities	17,966	3,577
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(9,660)	5,750
CASH AND CASH EQUIVALENTS—Beginning of year	23,680	17,930
CASH AND CASH EQUIVALENTS—End of year	$ 14,020	$ 23,680
SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Interest paid	$ 2,096	$ 2,190
Property additions included in accounts payable	$ 2,486	$ 3,412

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 US 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 US government agencies could have a material impact on the operations and cash flows of TSRI.

TSRI also operates a graduate school known as The Scripps Resarch Institute Graduate Program ("The Grad School"). Accredited by the Western Association of Schools and Colleges, The Grad 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 a 70-acre parcel (the "Briger parcel") located across the street from FAU. The County's 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.

Scripps Florida will be responsible for a special tax assessment estimated at $20.4 million and payable over 30 years beginning in 2017. This assessment is levied by the County to pay for certain infrastructure surrounding and benefiting the Briger parcel. The amounts will be capitalized when paid and amortized over 30 years.

Accounting Standards Adopted – In May 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2015-07, *Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*. ASU No. 2015-07 removes the requirement to categorize investments for which the fair values are measured using the Net Asset Value (NAV) per share practical expedient within the fair value hierarchy. It also limits certain disclosures to investments for which the entity has elected to measure the fair value using the practical expedient. ASU No. 2015-07 is effective for fiscal years beginning after December 15, 2015, with early adoption permitted. Management has elected to adopt ASU No. 2015-07 early. The adoption of ASU No. 2015-07 is reflected in Note 2 to the financial statements.

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.

Temporarily Restricted Net Assets—Temporarily restricted net assets result from amounts designated by donors for use in future periods, or 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.

Revenue Recognition—Grant applications are submitted to various federal and nonfederal agencies. Those applications that are funded are typically awarded for a five-year period, with the amount awarded negotiated in advance. Grant revenue is recognized as unrestricted revenue when the research costs are incurred. Unspent grant funds received in advance of the related expenditure, or before the conditions of the grant are met, are reported as deferred revenue.

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 that 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.

Affiliation and Collaboration Agreements – From time to time, TSRI enters into various agreements with other organizations to explore joint operating opportunities. Results of operations or financial position of affiliated organizations are included in TSRI's financial statements when there is majority voting control of, and financial interest in, the affiliated organization.

Use of Estimates and Assumptions—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("generally accepted accounting principles") 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 FASB Accounting Standards Codification (ASC) 855, *Subsequent Events*, TSRI evaluated subsequent events through December 20, 2016, 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 alternative investments to increase portfolio diversification and return and to reduce volatility.

Investments at fair value as of September 30, 2016 and 2015, are summarized as follows (in thousands):

	2016	2015
Cash and short-term investment funds	$107,592	$128,616
Growth assets:		
Global equity and convertible securities	128,839	111,266
Total return hedge funds	50,317	49,749
Private equity LPs	24,987	26,197
Inflation protection assets:		
Private real estate LPs	5,597	7,351
Private oil and gas LPs	6,950	6,168
Risk reduction assets:		
Government, mortgage, and corporate debt funds	29,035	28,092
Absolute return strategy funds	23,082	22,137
Total	$376,399	$379,576

Investments with a fair value of $1.3 million and $1 million at September 30, 2016 and 2015, 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 $866,000 and $780,000 at September 30, 2016 and 2015, is based on life expectancies and the annual payment required, discounted at an interest rate of 6% for 2016 and 2015.

Unspent grant funds restricted to support the Florida division totaled $51.6 million and $66.6 million at September 30, 2016 and 2015, 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 (loss) for the years ended September 30, 2016 and 2015, includes the following (in thousands):

	2016	2015
Interest and dividends:		
Unrestricted	$ 4,350	$ 3,974
Temporarily restricted	2,225	2,704
Permanently restricted		8
Net gains (losses):		
Unrestricted	9,864	(7,218)
Temporarily restricted	6,908	(6,157)
Permanently restricted		(722)
Investment income (loss)—net	$ 23,347	$(7,411)

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*, as follows:

Level 1—Refers to securities valued using quoted prices in active markets for identical assets or *liabilities.*

Level 2—Refers to securities valued using inputs 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—Refers to securities valued using inputs 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—Includes 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. These securities are classified as Level 1.

Nonmarketable Securities—Includes real estate and oil and gas limited partnerships (LPs). These investments consist of fund holdings with varying redemption terms and conditions and are valued using discounted cash flow and other valuation models, and are classified as Level 3.

Investments Valued at NAV-Investments valued using the NAV practical expedient include short-term investment-grade commingled funds, total return hedge funds, private equity LPs and absolute return strategy funds. Such investments are not classified in the fair value hierarchy.

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 are calculated by utilizing interest rates and actuarial inputs, and have been classified as Level 2.

The assets and liabilities measured at fair value on a recurring basis as of September 30, 2016 and 2015, including the fair value hierarchy of the valuation techniques utilized to determine such fair value, are as follows (in thousands):

2016	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Unobservable Inputs (Level 3)**	**Balance September 30, 2016**
ASSETS			
Investments in the fair value hierarchy:			
Marketable securities:			
Cash and short-term investment funds	$ 86,148	$	$ 86,148
Global equity and convertible securities	128,137		128,137
Government, mortgage, and corporate debt funds	28,519		28,519
Total marketable securities	242,804		242,804
Nonmarketable securities:			
Private real estate LPs		5,597	5,597
Private oil and gas LPs		6,950	6,950
Total nonmarketable securities		12,547	12,547
Total investments in the hierarchy	242,804	12,547	255,351
Investments valued at NAV:			
Cash and short-term investment funds			21,365
Total return hedge funds			50,317
Private equity LPs			24,987
Absolute return strategy funds			23,082
Total investments at NAV			119,751
Gift annuities and unitrusts:			
Cash and short-term investment funds	79		79
Global equity and convertible securities	702		702
Government, mortgage, and corporate debt funds	516		516
Total gift annuities and unitrusts	1,297		1,297
Total	$ 244,101	$ 12,547	$ 376,399
LIABILITIES			
Gift annuities and unitrusts (Level 2)			$ 866

2015	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Unobservable Inputs (Level 3)	Balance September 30, 2015
ASSETS			
Investments in the fair value hierarchy:			
Marketable securities:			
Cash and short-term investment funds	$106,218	$ -	$106,218
Global equity and convertible securities	110,751		110,751
Government, mortgage, and corporate debt funds	27,575		27,575
Total marketable securities	244,544	-	244,544
Nonmarketable securities:			
Private real estate LPs		7,351	7,351
Private oil and gas LPs		6,168	6,168
Total nonmarketable securities	-	13,519	13,519
Total investments in the hierarchy	244,544	13,519	258,063
Investments valued at NAV:			
Cash and short-term investment funds			22,300
Total return hedge funds			49,749
Private equity LPs			26,197
Absolute return strategy funds			22,137
Total investments at NAV	-	-	120,383
Gift annuities and unitrusts:			
Cash and short-term investment funds	99		99
Global equity and convertible securities	515		515
Government, mortgage, and corporate debt funds	516		516
Total gift annuities and unitrusts	1,130	-	1,130
Total	$245,674	$ 13,519	$379,576
LIABILITIES			
Gift annuities and unitrusts (Level 2)			$ 780

There were no significant transfers between Level 1, Level 2, and Level 3 of the fair value hierarchy for the years ended September 30, 2016 and 2015. The changes in Level 3 instruments measured on a recurring basis for the years ended September 30, 2016 and 2015, are as follows (in thousands):

Balance—September 30, 2014	$ 15,517
Net realized and unrealized loss	(3,145)
Purchases	2,847
Settlements	(1,700)
Balance—September 30, 2015	13,519
Net realized and unrealized loss	(735)
Purchases	1,551
Settlements	(1,788)
Balance—September 30, 2016	$ 12,547

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 investments under ASC 820, as amended. A summary of investments with a reported NAV as of September 30, 2016 and 2015, is as follows (in thousands):

	Investments with a Reported NAV September 30, 2016					
Investment	**Fair Value**		**Unfunded Commitment**	**Redemption Frequency**	**Other Redemption Restrictions**	**Redemption Notice Period**
Short term investment funds	$ 21,365	*	$	Monthly		<31 days
Alternative investment funds—Nonmarketable:						
Total return hedge funds	50,317	*		Quarterly: 2-year rolling		60–90 days
Private equity real estate LPs	5,597		1,255	N/A	Not eligible for redemption	N/A
Private equity LPs	24,987	*	12,309	N/A	Not eligible for redemption	N/A
Private oil and gas LPs	6,950		1,607	N/A	Not eligible for redemption	N/A
Absolute return strategy funds	23,082	*		Quarterly—annual		60–90 days
Total	$132,298		$15,171			

Investment	Fair Value		Unfunded Commitment	Redemption Frequency	Other Redemption Restrictions	Redemption Notice Period
	Investments with a Reported NAV September 30, 2015					
Short term investment funds	$ 22,300	*	$ -	Monthly		<31 days
Alternative investment funds—Nonmarketable:						
Total return hedge funds	49,749	*		Quarterly: 2-year rolling		60–90 days
Private equity real estate LPs	7,351		1,030	N/A	Not eligible for redemption	N/A
Private equity LPs	26,197	*	16,718	N/A	Not eligible for redemption	N/A
Private oil and gas LPs	6,168		1,290	N/A	Not eligible for redemption	N/A
Absolute return strategy funds	22,137	*		Quarterly—annual		60–90 days
Total	$133,902		$19,038			

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

Endowment—TSRI's endowment consists of 74 individual funds established for various purposes, including both donor-restricted funds and funds designated by the board of directors to function as endowments. As required by generally accepted accounting principles, net assets associated with endowment funds, including funds designated by the board of directors to function as endowments, are classified and reported based on the existence, or absence, of donor-imposed restrictions.

TSRI's board of directors 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 of director, 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, 2016 and 2015, include net assets restricted for use in future periods or for designated research purposes as follows (in thousands):

	2016	2015
Restricted for future periods	$ 61,564	$ 66,927
Restricted for research and other purposes	115,125	103,520
Total	$176,689	$170,447

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, 2016 and 2015, are as follows (in thousands):

	2016	2015
Satisfaction of time restrictions	$ 2,862	$ 5,102
Satisfaction of purpose restrictions—research	28,960	32,591
Total net assets released from restrictions	$31,822	$37,693

The endowment net assets' composition by type of fund as of September 30, 2016 and 2015, is as follows (in thousands):

2016	**Unrestricted**	**Restricted**	**Restricted**	**Total**
Donor-restricted endowment funds and net appreciation	$ -	$61,260	$50,400	$111,660
Board-designated endowment funds	22,251			22,251
Total funds	$22,251	$61,260	$50,400	$133,911
2015				
Donor-restricted endowment funds and net appreciation	$ -	$65,813	$46,887	$112,700
Board-designated endowment funds	22,408			22,408
Total funds	$22,408	$65,813	$46,887	$135,108

The changes in endowment net assets as of September 30, 2016 and 2015, are as follows (in thousands):

	Unrestricted	**Temporarily Restricted**	**Permanently Restricted**	**Total**
Endowment net assets—September 30, 2014	$23,898	$74,965	$41,744	$136,201
Investment income	201	808	8	1,017
Realized and unrealized losses	(998)	(3,957)	(721)	(5,676)
Contributions		305	5,868	6,173
Appropriation of endowment assets for expenditure	(693)	(6,308)		(7,001)
Other changes—unitrust disbursements			(12)	(12)
Endowment net assets—September 30, 2015	22,408	65,813	46,887	130,702
Investment income	276	1,315		1,591
Realized and unrealized gains	1,015	5,406		6,421
Contributions			3,513	3,513
Appropriation of endowment assets for expenditure and other	(1,448)	(11,274)		(12,722)
Endowment net assets—September 30, 2016	$22,251	$61,260	$50,400	$129,505

The description of the amounts classified as restricted net assets as of September 30, 2016 and 2015, are as follows (in thousands):

	2016	2015
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	$50,400	$46,887
Temporarily restricted net assets—the portion of perpetual endowment funds subject to a time restriction under FASB ASC 958	$61,260	$65,813

3. PLEDGES RECEIVABLE—NET

Pledges receivable—net as of September 30, 2016 and 2015, included in other assets and receivables in the accompanying balance sheets, are summarized as follows (in thousands):

	2016	2015
Pledges receivable—restricted to future periods—net:		
Unconditional promises to give	$ 1,994	$ 2,865
Less unamortized discount	(204)	(266)
Subtotal	1,790	2,599
Less allowance for uncollectibles	(1,486)	(1,486)
Total	$ 304	$ 1,113
Amounts due in:		
Less than one year	$ 1,192	
One to five years	802	
Total	$ 1,994	

Discount rates ranged from 0.3% to 5.25% for 2016 and 2015.

4. PROPERTY

Property recorded at cost as of September 30, 2016 and 2015, is summarized as follows (in thousands):

	2016	2015
Land	$ 42,646	$ 42,646
Buildings	436,056	431,649
Equipment	261,667	264,784
Other assets	4,118	4,029
Total property	744,487	743,108
Less accumulated depreciation and amortization	(423,665)	(406,911)
Property—net	$ 320,822	$ 336,197

The estimated useful lives of buildings are 30 to 35 years and equipment are three to seven years. Property is depreciated utilizing the straight-line method.

Depreciation expense was $32.3 million and $32.4 million for the years ended September 30, 2016 and 2015, respectively.

5. DEBT

In August 2016, the Institute borrowed $33.8 million through the issuance of Tax-Exempt Limited Revenue Obligations Series 2016A (the “2016A Obligations”) and $15.4 million Taxable Revenue Obligations Series 2016B (the “2016B Obligations”) sponsored by the California Infrastructure and Economic Development Bank. The proceeds from the 2016A Obligations were used to redeem bonds issued in 2000 and 2005, including defeasance of $8.1 million. The proceeds from the 2016B Obligations are restricted for use to fund certain building improvements and repairs. The 2016A Obligations were sold at a premium of $6.8 million which is being amortized over the term of the 2016A Obligations. As of September 30, 2016, the unamortized premium was $6.7 million. Unspent proceeds of $15.0 million are held in trust and recorded as other assets. The unspent proceeds are invested in a short-term United States government securities fund which is classified as Level 1 in the fair value hierarchy.

The 2016A Obligations mature in 2030 with principal due in varying annual installments; interest is payable on a semiannual basis at rates ranging from 4% to 5%. The 2016B Obligations mature in 2046 with principal due in varying annual installments; interest is payable on a semiannual basis at rates ranging from 1.05% to 3.67%.

The 2016A and 2016B Obligations are collateralized by a pledge of the Institute’s revenues and are subject to compliance with certain debt covenants, including restrictions on the issuance of parity debt.

The estimated fair value of the Institute’s debt, calculated using market observable interest rates (Level 2 inputs) as of September 30, 2016 and 2015, is $55.7 million and $41.3 million, respectively.

Total bond interest expense incurred for the years ended September 30, 2016 and 2015, was $2.1 and $2.2 million respectively.

Scheduled principal repayments on long-term debt as of September 30, 2016, are as follows (in thousands):

Years Ending September 30	
2017	$ 2,880
2018	2,670
2019	2,510
2020	2,620
2021	2,755
Thereafter	35,755
Total	$ 49,190

6. POSTRETIREMENT BENEFITS AND OTHER

Postretirement benefits and other as of September 30, 2016 and 2015, include benefit obligations as follows (in thousands):

	2016	**2015**
Defined benefit plan	$27,776	$24,972
Deferred compensation and other	6,388	6,291
Total postretirement benefits	$34,164	$31,263

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 postretirement 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 replacement defined contribution plan (the "TSRI Employment Retirement Plan"), which totaled $2.5 million and $2.6 million for the years ended September 30, 2016 and 2015, respectively.

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 $8.0 million and $8.4 million for the years ended September 30, 2016 and 2015, respectively.

Employees who were eligible to participate in the TSRI Cash Balance Retirement Plan, or 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 $742,000 and $780,000 for the years ended September 30, 2016 and 2015, respectively.

A summary of the changes in the benefit obligation and Plan assets at September 30, 2016 and 2015, is presented below (in thousands):

	2016	**2015**
Change in projected benefit obligation (PBO):		
PBO at prior measurement date	$ 82,135	$82,939
Service cost	345	370
Interest cost	3,718	3,656
Actuarial loss (gain)	8,148	(73)
Benefits paid	(4,395)	(4,412)
Administrative expenses paid	(369)	(345)
PBO at current measurement date	$ 89,582	$82,135
Change in plan assets:		
Fair value of assets at prior measurement date	$ 57,163	$59,131
Actual gain (loss) on assets	7,005	(7)
Employer contributions	2,402	2,796
Benefits paid	(4,395)	(4,412)
Administrative expenses paid	(369)	(345)
Fair value of assets at current measurement date	$ 61,806	$57,163
Components of net periodic pension expense:		
Service cost	$ 345	$ 370
Interest cost	3,718	3,656
Expected return on assets	(3,999)	(3,818)
Net gain amortization	2,338	2,589
Net periodic pension expense	$ 2,402	$ 2,797

Assuming no further significant changes in the Plan's design or valuation assumptions, net periodic pension expense and contribution for the year ended September 30, 2017, would be approximately $2.6 million. The amortization of net loss for the year ended September 30, 2017, would be $2.7 million.

Generally, the line item pension-related changes other than net periodic pension expense includes the annual adjustment required to reflect the unfunded defined pension plan liability based on the most recent actuarial valuation. As of September 30, 2016 and 2015, the accumulated amount of these annual adjustments was $32.6 million and $29.8 million, respectively. Going forward, these accumulations are expected to be amortized as a component of net periodic pension expense.

A reconciliation of the funded status of the Plan at September 30, 2016 and 2015, is as follows (in thousands):

	2016	**2015**
Accumulated benefit obligation	$(89,582)	$(82,135)
Projected benefit obligation	$(89,582)	$(82,135)
Fair value of assets	61,806	57,163
Funded status	$(27,776)	$(24,972)

Assumptions used to determine the PBO for the years ended September 30, 2016 and 2015, are as follows:

	2016	**2015**
Discount rate	3.8 %	4.7 %
Measurement date—September 30	2016	2015
Census date—January 1	2016	2015

Assumptions used to determine expense for the years ended September 30, 2016 and 2015, are as follows:

	2016	**2015**
Discount rate	4.7 %	4.5 %
Long-term rate of return on assets	7.0 %	6.8 %
Compensation increase rate	N/A	N/A

Expected benefit payments as of September 30, 2016, are as follows (in thousands):

Years Ending September 30	
2017	$5,761
2018	5,372
2019	5,340
2020	4,675
2021	4,791
Thereafter through 2026	22,818

The investment committee of the board of directors 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 of directors. 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 advisers manage Plan investments.

An independent outsourced chief investment officer 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. The 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, 2016 and 2015, including the fair value hierarchy of the valuation techniques utilized to determine such fair value, are as follows (see Note 2—Investments for a description) (in thousands):

Balance as of September 30, 2016	**Level 1**	**Total Assets 2016**	**% of Plan Assets 2016**	**% Target Allocation 2017**
Investments in fair value hierarchy:				
Mutual funds	$30,950	$30,950	50 %	50 %
Investments valued at NAV:				
Common/Collective trust funds		1,997	3%	0%
Total return hedge funds		7,445	12%	12%
Private equity LPs		4,665	8%	7%
Private oil and gas LPs		835	1%	1%
Government, mortgage, and corporate debt funds		15,914	26%	30%
Total investments valued at NAV		30,856	50%	50%
Total	$30,950	$61,806	100 %	100 %

Balance as of September 30, 2015	**Level 1**	**Total Assets 2015**	**% of Plan Assets 2015**	**% Target Allocation 2016**
Investments in fair value hierarchy:				
Mutual funds	$27,389	$27,389	48%	51%
Assets valued at NAV:				
Common/Collective trust funds		1,210	2%	0%
Total return hedge funds		7,355	13%	12%
Private equity LPs		4,893	9%	7%
Private oil and gas LPs		666	1%	0%
Government, mortgage, and corporate debt funds		15,650	27%	30%
Total investments valued at NAV		29,774	52%	49%
Total	$27,389	$57,163	100%	100%

All investments in the fair value hierarchy were classified as Level 1, and there were no significant transfers between Level 1, Level 2, and Level 3 of the fair value hierarchy for the years ended September 30, 2016 and 2015.

A summary of the Plan's investments with a reported NAV as of September 30, 2016 and 2015, is as follows (in thousands):

	Fair Value Estimated Using NAV per Share September 30, 2016				
Investment	**Fair Value** *	**Unfunded Commitment**	**Redemption Frequency**	**Other Redemption Restrictions**	**Redemption Notice Period**
Common/collective trust funds:					
Cash and short-term funds	$ 1,997	$	Daily		None
Government, mortgage, and corporate debt funds	15,914		Weekly		60-90 days
Alternative investment funds:					
Total return hedge funds	7,445		Quarterly		60-90 days
Private oil and gas LPs	835	165	N/A	Not eligible	N/A
Private equity LPs	4,665	1,478	N/A	Not eligible	N/A
Total	$ 30,856	$ 1,643			

	Fair Value Estimated Using NAV per Share September 30, 2015				
Investment	**Fair Value** *	**Unfunded Commitment**	**Redemption Frequency**	**Other Redemption Restrictions**	**Redemption Notice Period**
Common/collective trust funds:					
Cash and short-term funds	$ 1,210	$ -	Daily		None
Government, mortgage, and corporate debt funds	15,650		Weekly		60-90 days
Alternative investment funds:					
Total return hedge funds	7,355		Quarterly		60-90 days
Private oil and gas LPs	666	345	N/A	Not eligible	N/A
Private equity LPs	4,893	1,728	N/A	Not eligible	N/A
Total	$ 29,774	$ 2,073			

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

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, 2016, are summarized as follows (in thousands):

Years Ending September 30	
2017	$ 17,646
2018	17,082
2019	13,610
2020	185
2021	138
Total	$ 48,661

Rental expense for operating leases totaled $18.4 million and $20.4 million for the years ended September 30, 2016 and 2015, respectively. The deferred rent liability on operating leases is included in postretirement benefits and other in the accompanying balance sheets and was $5.8 million and $7.5 million at September 30, 2016 and 2015, respectively. The receivables from third parties for scheduled rent increases was $5.0 million and $6.6 million at September 30, 2016 and 2015, respectively. This receivables 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.

In July 2015, TSRI received an inquiry from the federal government regarding its records associated with government-sponsored research. TSRI is fully cooperating with the federal authorities during this early stage of its inquiry. Since this matter is still ongoing, no projections or determinations can be made at this time with respect to the ultimate outcome of this matter or whether this will have any 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. On July 9, 2015, the FASB decided to delay the effective date of ASU No. 2014-09 by one year allowing early adoption as of the original effective date January 1, 2017. The deferral results in the new revenue standard being effective January 1, 2018. Management of TSRI is in the process of evaluating the impact that the adoption of ASU No. 2014-09 will have on these 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 No. 2014-15 is effective for annual periods ending after December 15, 2016. Management of TSRI does not expect the adoption of ASU No. 2014-15 to have an impact on these financial statements.

In April 2015, the FASB issued ASU No. 2015-03, *Imputation of Interest—Simplifying the Presentation of Debt Issuance Costs*. This update changes the presentation of debt issuance costs in the financial statements. Under this ASU, an entity presents such costs in the balance sheet as a direct deduction from the recognized debt liability rather than as an asset. Amortization of the costs is reported as interest expense. ASU No. 2015-03 is effective for fiscal years beginning after December 15, 2015. Management of TSRI does not expect the adoption of ASU No. 2015-03 to have a material impact on the financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases*. The ASU requires lessees to recognize assets and liabilities arising from leases on the balance sheet. Under the ASU, a lessee should recognize in the statements of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018. Early adoption is permitted. Management of TSRI is in the process of evaluating the impact that the adoption of ASU 2016-02 will have on the financial statements.

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities—Presentation of Financial Statements for Not-for-Profit Entities*. The ASU makes several improvements to current reporting requirements to provide more useful information to donors, grantors, creditors, and other users of the financial statements. ASU 2016-14 is effective for fiscal years beginning after December 15, 2017. Early adoption is permitted. Management of TSRI is in the process of evaluating the impact that the adoption of ASU 2016-14 will have on the financial statements.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows—Classification of Certain Cash Receipts and Cash Payments*. The ASU addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice of how certain cash receipts and cash payments are presented and classified in the statement of cash flows. ASU 2016-15 is effective for fiscal years beginning after December 15, 2018. Early adoption is permitted. Management of TSRI is in the process of evaluating the impact that the adoption of ASU 2016-15 will have on the financial statements.

9. SUBSEQUENT EVENT

On October 1, 2016, TSRI entered into an affiliation agreement (the "Affiliation Agreement") with The California Institute for Biomedical Research (CALIBR). Under the terms of the Affiliation Agreement, TSRI and CALIBR will explore opportunities to combine TSRI's research expertise with CALIBR's drug development expertise, create joint faculty appointments and other faculty opportunities, establish joint philanthropy and fundraising efforts, develop shared research services and administrative overhead services, and develop appropriate revenue-sharing and other joint operating activities under collaboration agreements.

A summary of the results of financial position and results of operations for CALIBR as of and for the year ended August 31, 2016 follows (in thousands) (unaudited):

Total Assets:	$45,727
Total Liabilities:	$17,389
Total Net Assets:	$28,338
Total Revenues:	$44,622
Total Expenses:	$45,229

CALIBR's financial position and results of operations will be consolidated when the affiliation meets the requirements in the accounting standards. Transaction costs incurred by TSRI in 2016 related to the Affiliation were not material.

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