

The Scripps Research Institute

Financial Statements for the Years Ended
September 30, 2008 and 2007, 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 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 period 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.

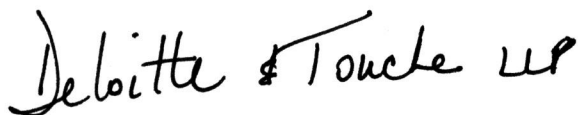
INDEPENDENT AUDITORS' REPORT

To the Board of Trustees of
The Scripps Research Institute:

We have audited the accompanying balance sheets of The Scripps Research Institute ("TSRI") as of September 30, 2008 and 2007, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the management of TSRI. 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 of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of TSRI's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of TSRI as of September 30, 2008 and 2007, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.



December 19, 2008

THE SCRIPPS RESEARCH INSTITUTE

BALANCE SHEETS SEPTEMBER 30, 2008 AND 2007 (In thousands)

	2008	2007
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 11,145	\$ 5,476
Investments	209,179	237,991
Grants and other receivables — Net	<u>65,393</u>	<u>52,593</u>
Total current assets	285,717	296,060
PROPERTY — Net	378,773	292,033
INVESTMENTS	116,681	141,798
DEPOSITS, PREPAID RENT, AND OTHER — Net	<u>38,103</u>	<u>38,054</u>
TOTAL	<u>\$ 819,274</u>	<u>\$ 767,945</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Accounts payable and accrued expenses	\$ 54,369	\$ 47,537
Deferred revenue	<u>20,679</u>	<u>16,477</u>
Total current liabilities	75,048	64,014
LONG-TERM DEBT	55,336	57,170
DEFERRED REVENUE AND OTHER	<u>26,389</u>	<u>122,154</u>
Total liabilities	<u>156,773</u>	<u>243,338</u>
NET ASSETS:		
Unrestricted	509,309	416,836
Temporarily restricted	117,532	73,040
Permanently restricted	<u>35,660</u>	<u>34,731</u>
Total net assets	<u>662,501</u>	<u>524,607</u>
TOTAL	<u>\$ 819,274</u>	<u>\$ 767,945</u>

See notes to financial statements.

THE SCRIPPS RESEARCH INSTITUTE

STATEMENTS OF ACTIVITIES YEARS ENDED SEPTEMBER 30, 2008 AND 2007 (In thousands)

	2008	2007
CHANGES IN UNRESTRICTED NET ASSETS:		
Revenue:		
Grants and contracts	\$ 476,211	\$ 296,700
Other revenue and support	37,082	36,097
Investment (loss) income	(51,122)	53,396
Net assets released from restrictions	<u>1,829</u>	<u>2,839</u>
Total revenue	<u>464,000</u>	<u>389,032</u>
Expenses:		
Research	324,385	319,112
Postgraduate and graduate education	19,846	20,060
Management and general	16,700	16,543
Other	<u>5,116</u>	<u>4,796</u>
Total expenses	<u>366,047</u>	<u>360,511</u>
INCREASE IN UNRESTRICTED NET ASSETS BEFORE EFFECT OF ADOPTION OF FASB STATEMENT NO. 158 AND OTHER CHANGES IN UNRESTRICTED NET ASSETS	97,953	28,521
OTHER CHANGES IN UNRESTRICTED NET ASSETS	(4,511)	
EFFECT OF ADOPTION OF FASB STATEMENT NO. 158	<u>(969)</u>	<u>512</u>
INCREASE IN UNRESTRICTED NET ASSETS	<u>92,473</u>	<u>29,033</u>
CHANGES IN TEMPORARILY RESTRICTED NET ASSETS:		
Grants	47,694	11,788
Other support and contributions	2,757	34
Investment (loss) income	(4,130)	2,730
Net assets released from restrictions	<u>(1,829)</u>	<u>(2,839)</u>
Increase in temporarily restricted net assets	<u>44,492</u>	<u>11,713</u>
CHANGES IN PERMANENTLY RESTRICTED NET ASSETS — Other support and contributions	<u>929</u>	<u>790</u>
INCREASE IN NET ASSETS	137,894	41,536
NET ASSETS — Beginning of year	<u>524,607</u>	<u>483,071</u>
NET ASSETS — End of year	<u>\$ 662,501</u>	<u>\$ 524,607</u>

See notes to financial statements.

THE SCRIPPS RESEARCH INSTITUTE

STATEMENTS OF CASH FLOWS YEARS ENDED SEPTEMBER 30, 2008 AND 2007 (In thousands)

	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES:		
Increase in net assets	\$ 137,894	\$ 41,536
Adjustments to reflect cash flows provided by operating activities:		
Depreciation and amortization	28,665	27,886
Realized and unrealized losses (gains) on investments	71,510	(44,622)
Contributions restricted for property acquisitions and other	(175,044)	(3,357)
Contributions restricted for endowment	(745)	(220)
Changes in assets and liabilities:		
Grants and other receivables	(12,800)	(22,096)
Deposits, prepaid rent, and other	(3,111)	(1,282)
Accounts payable and accrued expenses	5,252	(515)
Deferred revenue and other	(8,246)	23,417
Net cash provided by operating activities	<u>43,375</u>	<u>20,747</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investments	(278,832)	(120,752)
Proceeds from sales of investments	261,251	115,990
Property additions	<u>(112,509)</u>	<u>(80,868)</u>
Net cash used in investing activities	<u>(130,090)</u>	<u>(85,630)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on long-term debt	(1,620)	(1,545)
Contributions restricted for endowment	745	220
Contributions restricted for property acquisitions	<u>93,259</u>	<u>61,957</u>
Net cash provided by financing activities	<u>92,384</u>	<u>60,632</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	5,669	(4,251)
CASH AND CASH EQUIVALENTS — Beginning of year	<u>5,476</u>	<u>9,727</u>
CASH AND CASH EQUIVALENTS — End of year	<u>\$ 11,145</u>	<u>\$ 5,476</u>
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES — Property additions included in accounts payable		
	<u>\$ 20,766</u>	<u>\$ 19,477</u>

See notes to financial statements.

THE SCRIPPS RESEARCH INSTITUTE

NOTES TO FINANCIAL STATEMENTS YEARS ENDED SEPTEMBER 30, 2008 AND 2007

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 confers the degrees of Doctor of Philosophy, Doctor of Philosophy — Honorary, and Master of Science. This program, which is accredited by the Western Association of Schools and Colleges, is known as The Kellogg School of Science and Technology.

The financial statements reflect all adjustments and estimates necessary for the fair presentation of financial position and results of operations in accordance with accounting principles generally accepted in the United States of America (“generally accepted accounting principles”).

Scripps Florida — Scripps Florida was established in January 2004 as an operating division of TSRI. Scripps Florida combines leading edge automated systems with research programs relevant to current medical needs in human diseases. Funding is provided by a \$310 million grant, plus interest, from the State of Florida. Grant proceeds are disbursed annually, over a 10-year period commencing in 2004 and are conditioned on compliance with certain covenants and conditions. Expended grant funds from the State of Florida are reflected as unrestricted revenue. Billed but unspent grant funds from the State of Florida are reflected as temporarily restricted net assets until spent.

The County of Palm Beach (the “County”) agreed to provide temporary space plus land and \$187 million in funding for the development of Scripps Florida’s permanent facility. The estimated fair rental value of the use of temporary facilities applicable to future periods is reported as prepaid rent and an increase in temporarily restricted net assets and is amortized ratably into unrestricted revenue and expense during occupancy. The grant for the construction of permanent facilities was recorded as construction in process (and property, upon completion) and deferred revenue, as costs were incurred. The balance in the deferred revenue account was recognized as unrestricted revenue during the year ended September 30, 2008, when completion and occupancy became probable. (The Certificate of Occupancy was issued by the County of Palm Beach in November 2008). Depreciation commenced upon occupancy.

The grant for the use of the land was reflected as prepaid rent and deferred revenue. Until occupancy became probable (during the year ended September 30, 2008), prepaid rent and deferred revenue were amortized, ratably, over the life of the 99-year lease and reflected as unrestricted expense and revenue. The remaining deferred revenue balance was recognized as temporarily restricted revenue when occupancy was probable and will be transferred to unrestricted revenue ratably over the remaining 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 and equipment. Items that affect this category consist of revenue and expenses associated with the primary objectives of TSRI and unrestricted gifts. In addition, changes to this category of net assets incorporate restricted gifts whose donor-imposed restrictions were met in the year received, through the passage of time, or through fulfillment of the restricted purpose. 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 contributions designated by donors for use in future periods, generally for specific research projects. Expirations of temporary restrictions are reported as unrestricted net assets released from restrictions when the restrictions of the gift have been satisfied. Gifts of cash for the acquisition of property are reported as net assets released from restriction when the property is placed in service. Restricted contributions whose restrictions are met in the same reporting period are reported as unrestricted support.

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 in California and Florida in exchange for research funding, royalties, or ownership participation. In arrangements that contain multiple elements, TSRI allocates revenue between the elements 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 standalone basis; and iii) there is objective and verifiable evidence of the fair value of the separate elements. The total value of the arrangement is either recognized 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.

During the year ended September 30, 2008, TSRI recognized revenue of \$3.3 million from activities licensed to one company of which approximately \$825,000 was paid to inventors.

In November 2006, TSRI entered into a Collaborative Research Agreement (the “Agreement”) with Pfizer Pharmaceutical Corporation (“Pfizer”). Under the Agreement, Pfizer receives a first right to enter into an option agreement to license inventions and receive assay designs made in TSRI laboratories in California and Florida. In exchange, TSRI receives \$100 million in unrestricted funding and other consideration, over five years. The Agreement, which is cancelable upon six months written notice, does not provide a refund provision in the event that TSRI is unable to deliver the assay designs. Revenue from this arrangement is recorded ratably, during each funding year.

During the year ended September 30, 2007, TSRI entered into two faculty recruitment funding agreements with Novartis Pharmaceutical Company (“Novartis”). Under the agreements, TSRI receives \$39 million over nine years to fund the recruitment of 19 scientists and equipment with an estimated fair value of \$417,000. In exchange, Novartis receives the right of first refusal to enter into an option to license any intellectual property originating in the laboratories of those scientists during the contract term. Revenue and expense of \$4.7 million and \$2.5 million was reported during the year ended September 30, 2008 and 2007, respectively.

The President of TSRI was an uncompensated member of the Board of Directors of a subsidiary corporation of Novartis at the commencement of the agreement. At September 30, 2008, he was no longer a member of that Board. This agreement was approved by the non-interested members of TSRI’s Board of Trustees pursuant to policies for the identification and management of conflicts, and the provisions of the California Corporations Code Section 5233.

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

Investments — Investments are carried at fair value that is generally determined by quoted market prices provided by independent outside valuation services. Current investments include unrestricted and temporarily restricted investments that are available for expenditure within one year. Long-term investments include permanently restricted investments, plus the related capital gains and losses and temporarily restricted investments that are available for expenditure beyond one year.

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.

Recent Accounting Pronouncements — The Financial Accounting Standards Board (FASB) has issued Statement No. 158, *Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans — an amendment of Statements No. 87, 88, 106, and 132(R)*, which requires a not-for-profit organization to recognize the overfunded or underfunded status of a defined benefit postretirement plan (measured as the difference between the fair value of plan assets and the projected benefit obligation as of the date of the fiscal year end) as an asset or liability in its balance sheet and to recognize changes in that funded status in the year in which the changes occur through changes in unrestricted net assets. The statement also includes certain disclosure requirements. Statement No. 158 is effective for TSRI for its year ended September 30, 2007 (2008 for the requirement to measure plan assets and benefit obligations as of the fiscal year end). See Note 7 for information on TSRI’s defined benefit plan.

The FASB has issued Statement No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. The FASB also issued FASB Staff Positions (“FSP’s”) 157-1, 157-2 and 157-3. These FSP’s i) exclude FASB Statement No. 13, *Accounting for Leases*, from the provisions of Statement No. 157; ii) delay the effective date for nonfinancial assets and liabilities to fiscal years beginning after November 15, 2008; and iii) clarify the application of Statement

No. 157 in a market that is not active. Statement No. 157 is effective for TSRI for its year ending September 30, 2009. Management has not completed its analysis of the effects of this statement.

The FASB has issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities — Including an amendment of Statement No. 115*, which permits entities to choose to measure many financial instruments and certain other items at fair value. This statement is effective for TSRI for its year ending September 30, 2009, provided that TSRI also elects to apply the provisions of Statement No. 157. Management has not completed its analysis of the effects, if any, of this statement.

The FASB has issued Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes — an interpretation of Statement No. 109*, as amended. FIN No. 48 i) clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with Statement No. 109, *Accounting for Income Taxes*; ii) prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or classification, interest and penalties, accounting in interim periods, disclosure, and transition. The statement was effective for TSRI for its year ended September 30, 2008. There were no material effects to TSRI's financial statements as a result of the adoption of FIN 48.

The FASB has issued Staff Position (FSP) 117-1, *Endowments of Not-for-Profit Organizations — Net Asset Classifications of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act (UPMIFA) and enhanced Disclosures for All Endowment Funds*. The State of California enacted the UPMIFA in September 2008 and the Act becomes effective in January 2009. The FSP provides guidance on classifying net assets associated with donor-restricted endowment funds and requires additional disclosures about endowments (both donor-restricted funds and board-designated funds) for all organizations. This statement is effective for TSRI for its year ending September 30, 2009. Management has not completed its analysis of the effects of this FSP.

Use of Estimates and Assumptions — The preparation of financial statements in conformity with 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.

2. SCRIPPS FLORIDA

The Florida Legislature enacted an Enabling Statute to create the Scripps Florida Funding Corporation ("SFFC"), a nonprofit Florida corporation, and to appropriate and distribute the \$310 million grant to SFFC. SFFC has responsibility to administer and disburse Florida's grant funds to TSRI for the benefit of the Scripps Florida division. The undistributed funds are primarily invested in issues of U.S. federal agencies and have laddered maturities that correspond, generally, to the expected date of distribution to TSRI. At September 30, 2008, \$120.7 million remains undistributed.

In February 2006, the County of Palm Beach voted to relocate Scripps Florida to a split-campus plan located on two sites: a 30-acre site on the Jupiter campus of Florida Atlantic University (FAU) and 70 acres of the parcel (known as the Briger parcel) located across the street from FAU (collectively, the "FAU/Briger site"). The County grant agreement for the permanent facilities includes: i) a 99-year sublease for the FAU land; ii) a 15-year lease for the Briger parcel, including an acquisition option; and iii) funding for construction of the permanent facilities on the FAU land. The lease for the Briger parcel has not yet been signed.

Vertical construction on the permanent site at FAU commenced in January 2007 and cumulative construction work-in-process costs of \$177 million and \$87.9 million were incurred as of September 30, 2008 and 2007, respectively. The County of Palm Beach issued the Certificate of Occupancy for the permanent site in November, 2008.

The financial statements include the recognition of deferred revenue of \$176.6 million related to construction of the permanent site, which was recognized as unrestricted revenue in March 2008 when completion of construction and occupancy became probable.

3. INVESTMENTS

TSRI's investment portfolio includes cash, marketable securities, and alternative strategies, which are held in mutual funds, commingled funds, separate accounts, and limited partnership interests.

Investments at fair value as of September 30, 2008 and 2007, are summarized as follows (in thousands of dollars):

	2008	2007
Cash and short-term investment funds with maturities of three months to one year	\$ 66,663	\$ 39,325
Domestic and foreign equities	68,456	208,421
Government, mortgage, and corporate debt	35,411	68,105
Alternative strategies	<u>155,330</u>	<u>63,938</u>
Total	<u>\$ 325,860</u>	<u>\$ 379,789</u>

Investments have declined since September 30, 2008, due to significant investment market volatility.

Alternative strategies include investment positions in i) commingled funds and limited liability corporations (\$56.3 million); ii) multi-strategy hedge funds and hedge fund-of-funds (\$49.8 million); and iii) limited partnerships (LP's) invested in energy, private equity, venture capital, real estate, convertible debt and distressed debt (\$49.2 million). In almost all cases, the individual securities held in commingled funds and limited liability corporations have readily determinable market values. The value of TSRI's investment in these vehicles, however, may not be equal to its ratable portion of the sum of the market values of those securities. Commingled funds and limited liability corporations provide monthly liquidity. Hedge funds and hedge fund-of funds provide, generally, quarterly liquidity. Certain LP's provide monthly liquidity (\$15.5 million). Investment positions in the remaining LP's are illiquid (although a secondary market exists). LP's do not have readily determinable market values and are subject to future capital calls of \$30.4 million at September 30, 2008.

Unspent grant funds restricted to support the Florida division totaled \$64.7 million and \$35.3 million at September 30, 2008 and 2007, respectively. These unspent funds are invested through a mutual fund in short-term, fixed income obligations with maturities of up to one year.

TSRI's portfolio is 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 reduce volatility.

Investments with a fair value of \$4.8 million and \$5.3 million at September 30, 2008 and 2007, respectively, 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. The liability to such beneficiaries of \$1.7 million and \$1.8 million at September 30, 2008 and 2007, respectively, is based on life expectancies and the annual payment required, discounted at the risk-free interest rate. The composition of investment income for the years ended September 30, 2008 and 2007, includes the following (in thousands of dollars):

	2008	2007
Interest and dividends:		
Unrestricted	\$ 15,880	\$ 11,188
Temporarily restricted	378	316
Net (losses) gains:		
Unrestricted	(67,002)	42,208
Temporarily restricted	<u>(4,508)</u>	<u>2,414</u>
Investment (loss) income	<u>\$ (55,252)</u>	<u>\$ 56,126</u>

4. PLEDGES RECEIVABLE — NET

Pledges receivable— net are included in Grants, Deposits, Prepaid Rent and Other — Net. At September 30, 2008 and 2007, pledges receivable-net are summarized as follows (in thousands of dollars):

	2008	2007
Pledges receivable — restricted to future periods — net:		
Unconditional promises to give before unamortized discount and allowance for uncollectibles	\$ 5,158	\$ 3,122
Less unamortized discount	<u>(747)</u>	<u>(379)</u>
Subtotal	4,411	2,743
Less allowance for uncollectibles	<u>(110)</u>	<u>(110)</u>
Total	<u>\$ 4,301</u>	<u>\$ 2,633</u>
Amounts due in:		
Less than one year	\$ 1,111	\$ 831
One to five years	3,206	1,991
More than five years	<u>841</u>	<u>300</u>
Total	<u>\$ 5,158</u>	<u>\$ 3,122</u>

Discount rates ranged from 3.54 % to 5.25% for the year ended September 30, 2008, and 4.35% to 5% for the year ended September 30, 2007.

5. PROPERTY

Property is carried at cost and depreciation is recorded using the straight-line method over the estimated useful lives of the assets or the lease term, whichever is less. Property at September 30, 2008 and 2007, is summarized as follows (in thousands of dollars):

	2008	2007
Land	\$ 19,646	\$ 19,646
Buildings	194,834	190,987
Equipment	195,065	186,156
Construction in process	176,996	87,930
Leasehold improvements and other assets	<u>24,299</u>	<u>21,649</u>
	610,840	506,368
Less accumulated depreciation and amortization	<u>(232,067)</u>	<u>(214,335)</u>
Total	<u>\$ 378,773</u>	<u>\$ 292,033</u>

6. LONG-TERM 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, 2008 and 2007.

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 semi-annual 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 5.0% to 5.04%. Approximately \$22 million of this debt was issued to redeem the 1994 debt issue. At September 30, 2008, the unamortized original issue premium on the 2005 bonds was \$2.8 million.

Interest paid in each of 2008 and 2007 on long-term debt was \$2.9 million. The estimated fair value of the tax-exempt bonds at September 30, 2008, was \$54.2 million.

Scheduled principal repayments on long-term debt are as follows (in thousands of dollars):

Years Ending September 30	
2009	\$ 1,700
2010	1,785
2011	1,870
2012	1,965
2013	2,065
Thereafter	<u>44,865</u>
Total	<u>\$ 54,250</u>

7. RETIREMENT PLANS

Defined Contribution Plan — TSRI provides a noncontributory Money Purchase Plan for scientific staff and management. Contributions under this plan, determined as a percentage of participant salary, totaled \$8.4 million for the year ended September 30, 2008, and \$8.2 million for the year ended September 30, 2007.

Supplemental Executive Retirement Plan (SERP) — TSRI provides a non-qualified SERP to selected participants that provide a benefit payment at age 63 equal to 70% of the last three years' average base pay (including values from Primary Social Security and other pension benefits earned). One executive, aged 57 at September 30, 2008, has been selected to participate in this plan. The potential unfunded liability under this plan totaled \$1.2 million at September 30, 2008 and \$904,000 at September 30, 2007.

Defined Benefit Plan — TSRI employees not covered by the defined contribution plan are covered by a defined benefit plan (the "Plan"). Pension benefits under the Plan are 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. TSRI's contributions to the Plan were \$3.9 million and \$4.5 million for the years ended September 30, 2008 and 2007, respectively. Payments to Plan beneficiaries totaled \$4.7 million and \$3.2 million for the years ended September 30, 2008 and 2007, respectively.

On January 1, 2000, the Plan incorporated a special minimum benefit based on average annual pay previously available only to those employees aged 50 or over on January 1, 1996, and to provide a 50% additional match in the form of a pay-based credit in the Plan up to 3% of pay. During the year ended September 30, 2006, and effective at January 1, 2008, the Plan was amended to change the vesting schedule from a five-year cliff vesting schedule to a three-year cliff vesting schedule.

A summary of the changes in the benefit obligation and plan assets at September 30, 2008 and 2007, is presented below (in thousands of dollars):

	2008	2007
Change in projected benefit obligation (PBO):		
PBO at prior measurement date	\$ 49,264	\$ 46,074
Service cost	3,925	4,180
Interest cost	2,956	2,812
Actuarial (loss) gain	(9,083)	981
Benefits paid	(4,684)	(3,167)
Administrative expenses paid	(304)	(228)
Plan amendment	<u> </u>	<u>(1,388)</u>
PBO at current measurement date	<u>\$ 42,074</u>	<u>\$ 49,264</u>
Change in plan assets:		
Fair value of assets at prior measurement date	\$ 52,180	\$ 43,026
Actual (loss) return on assets	(11,379)	8,057
Employer contributions	3,875	4,492
Benefits paid	(4,684)	(3,167)
Administrative expenses paid	<u>(304)</u>	<u>(228)</u>
Fair value of assets at current measurement date	<u>\$ 39,688</u>	<u>\$ 52,180</u>

Due to significant investment market volatility, Defined Benefit Plan investments at estimated fair value at November 30, 2008 totaled \$31.6 million.

Assuming no significant changes in plan design or valuation assumptions, net periodic pension expense for the year ending September 30, 2009, is expected to be approximately \$3.0 million.

During the year ended September 30, 2008, TSRI adopted the measurement date provisions of FASB Statement No. 158, which resulted in a reduction in unrestricted net assets of \$1.0 million.

During the year ended September 30, 2007, TSRI adopted the recognition provisions of FASB Statement No. 158, which resulted in an increase in unrestricted net assets of \$512,000. The effect on the financial statements at September 30, 2007 related to the adoption of the recognition provisions of this statement is as follows (in thousands of dollars):

	Before Application of Statement 158	Effect of Adopting FASB Statement 158	As Reported
Assets:			
Prepaid pension cost	\$ 2,389	\$ 527	\$ 2,916
Unbilled grants	<u> </u>	<u>139</u>	<u>139</u>
Total	<u>\$ 2,389</u>	<u>\$ 666</u>	<u>\$ 3,055</u>
Liabilities and Net Assets:			
Liability for pension (SERP)	\$ 750	\$ 154	\$ 904
Unrestricted net assets	<u>1,639</u>	<u>512</u>	<u>2,151</u>
Total	<u>\$ 2,389</u>	<u>\$ 666</u>	<u>\$ 3,055</u>

A reconciliation of funded status of the cash balance plan at September 30, 2008 and 2007, is as follows (in thousands of dollars):

	2008	2007
Accumulated benefit obligation	<u>\$ (37,674)</u>	<u>\$ (42,509)</u>
Projected benefit obligation	\$ (42,074)	\$ (49,264)
Fair value of assets	<u>39,688</u>	<u>52,180</u>
Funded status	(2,386)	2,916
Unrecognized prior service cost	1,027	1,381
Unrecognized net loss (gain)	<u>2,779</u>	<u>(1,908)</u>
Prepaid benefit cost	<u>\$ 1,420</u>	<u>\$ 2,389</u>

Assumptions used to determine the projected benefit obligation for the years ended September 30, 2008 and 2007, are as follows:

	2008	2007
Discount rate	8.1 %	6.4 %
Compensation increase rate	4.0 %	4.5 %
Measurement date	September 30, 2008	June 30, 2007
Census date	October 1, 2008	July 1, 2007

Assumptions used to determine expense for the years ended September 30, 2008 and 2007, are as follows:

	2008	2007
Discount rate	6.42 %	6.42 %
Long-term rate of return on assets	7.60	7.60
Compensation increase rate	4.50	4.50

As of September 30, 2008, expected benefit payments are as follows (in thousands of dollars):

**Years Ending
September 30**

2009	\$ 4,784
2010	4,509
2011	4,489
2012	4,890
2013	5,266
Thereafter through 2018	25,066

The Plan's assets by category as of September 30, 2008 and 2007, are as follows:

	<u>2008</u>		<u>2007</u>	
	<u>Target</u>	<u>Actual</u>	<u>Target</u>	<u>Actual</u>
Foreign and domestic equity securities	55 %	60 %	55 %	70 %
Government, mortgage and corporate debt instruments	15	15	15	10
Real estate investment trusts	10	8	10	7
Absolute return strategies, private equity, and cash	<u>20</u>	<u>17</u>	<u>20</u>	<u>13</u>
	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>

The Plan invests in mutual funds, commingled funds, separate accounts, and limited partnership interests.

The Investment Committee of the Board of Trustees 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, limited partnerships, 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 invested at the discretion of managers with distinct investment styles and specific guidelines. The allocation to absolute return strategies is invested in multi-strategy hedge "fund-of-funds" limited partnerships, private equity, and cash. Professional investment advisors manage Plan investments.

An independent investment consultant recommends alternative diversification models, provides professional performance evaluation, identifies potential 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.

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.

8. COMMITMENTS AND CONTINGENCIES

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

Years Ending September 30	
2009	\$ 22,941
2010	21,618
2011	22,242
2012	22,910
2013	23,597
Thereafter	<u>77,584</u>
Total	<u>\$ 190,892</u>

Rental expense for operating leases totaled \$27.0 million and \$25.1 million for the years ended September 30, 2008 and 2007, respectively.

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 the liabilities, if any, under these claims are adequately covered by insurance or will not be material to the financial statements.