RESEARCH CORPORATION FOR SCIENCE ADVANCEMENT

YEARS ENDED DECEMBER 31, 2017 AND 2016

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CONTENTS

Independent Auditors' Report

Board of Directors and Management
Research Corporation for Science Advancement
Tucson, Arizona

We have audited the accompanying financial statements of Research Corporation for Science Advancement (the Foundation), which comprise the statements of financial position as of December 31, 2017 and 2016, 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' 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 Foundation'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 Foundation'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 Research Corporation for Science Advancement as of December 31, 2017 and 2016, 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.

BeachFleischman PC

Tucson, Arizona
April 26, 2018

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RESEARCH CORPORATION FOR SCIENCE ADVANCEMENT

STATEMENTS OF FINANCIAL POSITION

DECEMBER 31, 2017 AND 2016

ASSETS

	2017	2016
Cash and cash equivalents	$ 2,270,546	$ 5,248,606
Investments	170,197,157	147,502,148
Other receivables	1,764,000	1,664,500
Other assets	247,859	229,265
Property and equipment, net of accumulated depreciation ($799,920, 2017; $790,837, 2016)	39,003	48,086
	$ 174,518,565	$ 154,692,605

LIABILITIES AND NET ASSETS

	2017	2016
Accounts payable and accrued expenses	$ 74,490	$ 54,476
Grants and awards payable	665,000	560,000
Postretirement benefit obligation	571,667	761,159
LBT liability	1,371,368	1,383,000
	2,682,525	2,758,635
Commitments and contingencies		
Net assets:		
Unrestricted	171,836,040	151,933,970
	$ 174,518,565	$ 154,692,605

See notes to financial statements.

RESEARCH CORPORATION FOR SCIENCE ADVANCEMENT

STATEMENT OF ACTIVITIES

YEARS ENDED DECEMBER 31, 2017 AND 2016

	2017	2016
Changes in unrestricted net assets:		
Revenues:		
Net investment income:		
Net capital gains	$ 25,854,767	$ 11,478,568
Interest and dividend income	1,040,840	973,583
	26,895,607	12,452,151
Expenses:		
Grants and awards approved	4,025,730	3,991,936
Programs	2,019,568	2,101,902
Supporting services	948,239	969,503
	6,993,537	7,063,341
Increase in unrestricted net assets	19,902,070	5,388,810
Net assets, beginning	151,933,970	146,545,160
Net assets, ending	$ 171,836,040	$ 151,933,970

See notes to financial statements.

RESEARCH CORPORATION FOR SCIENCE ADVANCEMENT

STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2017 AND 2016

	2017	2016
Cash flows from operating activities:		
Increase in net assets	$ 19,902,070	$ 5,388,810
Adjustments to reconcile increase in net assets to net cash used in operating activities:		
Depreciation	9,083	9,083
Net realized and unrealized gains on investments	(28,677,182)	(13,718,066)
Changes in operating assets and liabilities:		
Other receivables	(99,500)	-
Other assets	(18,594)	20,406
Accounts payable and accrued expenses	20,014	(15,399)
Grants and awards payable	105,000	(690,569)
Postretirement benefit obligation	(189,492)	26,368
LBT liability	(11,632)	(17,000)
Net adjustments	(28,862,303)	(14,385,177)
Net cash used in operating activities	(8,960,233)	(8,996,367)
Cash flows from investing activities:		
Purchases of investments	(10,462,501)	(8,687,500)
Proceeds from sale/maturity of investments	16,444,674	20,725,429
Net cash provided by investing activities	5,982,173	12,037,929
Net increase (decrease) in cash and cash equivalents	(2,978,060)	3,041,562
Cash and cash equivalents, beginning	5,248,606	2,207,044
Cash and cash equivalents, ending	$ 2,270,546	$ 5,248,606

See notes to financial statements.

RESEARCH CORPORATION FOR SCIENCE ADVANCEMENT

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2017 AND 2016

1. Description of foundation and summary of significant accounting policies:

Organization:

Research Corporation is a private operating foundation incorporated in New York doing business as Research Corporation for Science Advancement (the Foundation). The Foundation is dedicated to the advancement of science.

Estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Financial statement presentation:

The Foundation reports information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets and permanently restricted net assets. Resources are reported for accounting purposes in separate classes of net assets based on the existence or absence of donor-imposed restrictions.

Cash and cash equivalents:

All highly liquid debt instruments purchased with a maturity of three months or less are considered to be cash equivalents. All cash and cash equivalents are placed with various credit institutions. At times, such amounts may be in excess of the FDIC and SIPC insurance limits; however, management does not believe they are exposed to any significant credit risk on cash and cash equivalents.

Investments:

Investments are carried at fair value. All of the Foundation's investments are held in professionally managed mutual funds, unconsolidated limited partnerships or special purpose entities.

Investment transactions are recorded on the trade date. Investment gains and losses include both realized and unrealized gains and losses and are included in the change in net assets in the accompanying statements of activities as increases or decreases in unrestricted net assets unless their use is temporarily or permanently restricted by explicit donor-imposed stipulations or legal requirements net of related investment fees. Realized gains or losses are recognized in the period sales or other transactions occur and are computed using the first-in, first-out method. Dividends and interest income are accrued when earned. Investments are considered to be impaired when a decline in fair value is judged to be other-than-temporary.

Fair value measurements:

Fair value is defined as the price to sell an asset or transfer a liability between market participants in an orderly exchange in the principal or most advantageous market for that asset or liability. Mutual funds are valued at quoted market prices. The fair value for the commingled funds and qualifying alternative investments is determined based on the investment's net asset value as a practical expedient. Considerable judgment is required in interpreting market data used to develop the estimates of fair value. Accordingly, the estimates presented in the financial statements are not necessarily indicative of the amounts that could be realized in a current market exchange. The use of different market assumptions and estimation methodologies may have a material effect on the estimated fair value.

1. Description of foundation and summary of significant accounting policies (continued):

Fair value financial instruments:

The Foundation's cash and cash equivalents, receivables, payables and other financial assets and liabilities not remeasured at fair value are carried at cost, which approximates fair value. These assets and liabilities are valued based on quoted prices for similar assets, quoted interest rates and other readily available market information (level 1 inputs). There have been no changes in the valuation methods or significant assumptions used to estimate the fair value. The fair value measurements for assets remeasured at fair value in the accompanying financial statements are disclosed in Note 4.

Other receivables:

The Foundation has sold or granted to astronomy research institutions all of its viewing rights in the Large Binocular Telescope (LBT) observatory along with the obligation to pay related operating costs associated with those rights. Other receivables at December 31, 2017 and 2016 consist of amounts owed to the Foundation from five institutions for costs that were paid by the Foundation on their behalf.

Grants and awards payable:

The Foundation accounts for its unconditional promises to give, which are normally in the form of grants or awards, as an expense in the year the unconditional promise is made. Any unpaid promises to give are reported as grants and awards payable.

Expense allocation:

Expenses that can be identified with a specific program or supporting service are charged directly to the program according to their natural expense classification. Costs incurred that share a common purpose are allocated based upon estimates made by management of time spent by employees on various activities. Investment expenses include an allocation of internal expenses, such as compensation and occupancy costs, for the Foundation's staff as well as amounts paid to third parties.

Income taxes:

The Foundation qualifies as a tax-exempt private operating foundation under Internal Revenue Code Section 4940(d). Income from certain activities not directly related to the Foundation's tax-exempt purpose may be subject to taxation as unrelated business taxable income (UBTI).

GAAP requires management to perform an evaluation of all tax positions taken or expected to be taken in the course of preparing the Foundation's tax returns to determine whether the tax positions meet a "more likely than not" standard of being sustained under examination by the applicable taxing authorities. This evaluation is required to be performed for all open tax years, as defined by the various statutes of limitations, for federal and state purposes.

The Foundation is only subject to income taxes on UBTI as applicable. As a result, the Foundation is required to file informational returns for federal and state purposes and, if it has UBTI, federal and state income tax returns. Management has performed its evaluation of tax positions taken on all open tax returns and has determined that there were no positions taken that do not meet the "more likely than not" standard.

1. Description of foundation and summary of significant accounting policies (continued):

Subsequent events:

The Foundation's management has evaluated the events that have occurred subsequent to December 31, 2017 through April 26, 2018, the date that the financial statements were available to be issued, and concluded that no additional disclosures are required. Management has no responsibility to update these financial statements for events and circumstances occurring after this date.

2. Liquidity and availability:

The Foundation manages its liquidity by maintaining adequate working capital, allocating a portion of its investments equal to 3 years of operating cash needs in highly liquid investments, and maintaining an available $5 million line of credit with a financial institution. The following table shows a determination of the Foundation's financial assets that are available to meet cash needs for program and general expenditures within one year:

	2017	2016
Cash and cash equivalents	$ 2,270,546	$ 5,248,606
Investments (less outstanding commitments of $7,175,000 and $12,137,500)	94,272,608	73,158,501
Other receivables	1,014,300	1,664,500
	$ 97,557,454	$ 80,071,607

3. Investments:

The investment goal of the Foundation is to maintain or grow its spending power in real (inflation adjusted) terms with risk at a level appropriate to the Foundation's programmatic spending and objectives. The Foundation diversifies its investments among various financial instruments and asset categories, including both active and passive approaches. The investments of the Foundation are managed by external investment management firms. The cost presented in the following table consists of cash invested less cash returned. The Foundation's investments consist of the following at December 31:

	2017		2016	
	Fair value	Cost	Fair value	Cost
Equity investments:				
Mutual funds	$ 79,399,980	$ 58,733,594	$ 68,711,709	$ 64,678,231
Equity investment funds	23,839,800	17,000,000	18,621,700	17,000,000
Fixed income investments:				
Money market funds	6,200,000	6,200,000	3,700,000	3,700,000
Short-term bond funds	15,847,628	15,975,849	12,884,291	12,975,849
Alternative investments:				
Multi strategy funds	27,985,112	4,159,711	27,478,900	4,474,188
Real estate strategy funds	7,985,563	6,407,811	6,167,545	5,242,187
CLO & other debt strategies funds	8,939,074	6,255,805	9,938,003	6,819,549
	$ 170,197,157	$ 114,732,770	$ 147,502,148	$ 114,890,004

3. Investments (continued):

The Foundation's equity investments are invested with independent managers with a global strategy, including exposure to emerging markets.

Net capital gains consists of the following:

	2017	2016
Net realized and unrealized gains on investments	$ 28,677,182	$ 13,718,066
Investment advisory fees	(2,624,861)	(2,010,802)
Internal investment management costs	(197,554)	(228,696)
	$ 25,854,767	$ 11,478,568

4. Fair value:

ASC 820 Fair Value Measurement establishes a fair value disclosure framework, which prioritizes and ranks the level of observable inputs used in measuring investments at fair value. The levels of the fair value hierarchy are as follows:

Level 1 - Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Foundation has the ability to access.

Level 2 - Inputs to the valuation methodology include the following items. If the asset has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in inactive markets or active markets that the Foundation does not have access to;
- Inputs other than quoted prices that are observable for the asset or liability;
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 - Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

Practical Expedient - Investments for which fair value is measured at net asset value per share (or its equivalent). Due to the inherent uncertainty of these estimates, these values may differ materially from the values that would have been used had a ready market for these investments existed. Investments that are included in this category generally include private fund investment structures and limited party interest, without quoted prices.

The investment's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

4. Fair value (continued):

At December 31, 2017, the fair value of investments measured on a recurring basis is as follows:

	Fair value	Practical expedient	Level 1	Level 2	Level 3
Equity investments:					
Mutual funds	$ 79,399,980	$ -	$ 79,399,980	$ -	$ -
Equity investment funds	23,839,800	23,839,800	-	-	-
Fixed income investments:					
Money market funds	6,200,000	-	6,200,000	-	-
Short-term bond funds	15,847,628	-	15,847,628	-	-
Alternative investments:					
Multi strategy funds	27,985,112	27,985,112	-	-	-
Real estate strategy funds	7,985,563	7,985,563	-	-	-
CLO & other debt strategies funds	8,939,074	8,939,074	-	-	-
	$ 170,197,157	$ 68,749,549	$ 101,447,608	$ -	$ -

At December 31, 2016, the fair value of investments measured on a recurring basis is as follows:

	Fair value	Practical expedient	Level 1	Level 2	Level 3
Equity investments:					
Mutual funds	$ 68,711,709	$ -	$ 68,711,709	$ -	$ -
Equity investment funds	18,621,700	18,621,700	-	-	-
Fixed income investments:					
Money Market Fund	3,700,000	-	3,700,000	-	-
Short-term bond funds	12,884,291	-	12,884,291	-	-
Alternative investments:					
Multi strategy funds	27,478,900	27,478,900	-	-	-
Real estate strategy funds	6,167,545	6,167,545	-	-	-
CLO & other debt strategies funds	9,938,003	9,938,003	-	-	-
	$ 147,502,148	$ 62,206,148	$ 85,296,000	$ -	$ -

The Foundation invested in marketable global equity securities through commingled funds that were limited to institutional and other qualified investors. The fair value of the commingled funds was based on the net asset value primarily derived from quoted prices in active markets of the underlying equity securities. Investments in mutual funds are valued at the closing price reported on the active market in which the individual funds are traded.

4. Fair value (continued):

The Foundation uses the net asset value per share as a practical expedient to estimate the fair value of alternative investments and certain equity investments. Since there is no readily available market for these investments, such investments are stated at fair values as estimated in an inactive market. These investments include assets that may not be immediately liquid, such as private debt securities, residual collateralized loan obligation (CLO) interests, real estate or other assets. The valuations of these investments are based upon year-end values provided by the investment managers using guidelines established by those investment managers and consideration of other factors related to the Foundation's interests in these investments. The Foundation obtains and considers the audited financial statements of such investments when evaluating the overall reasonableness of carrying value. The Foundation believes this method provides a reasonable estimate of fair value. However, the recorded value may differ from the fair value had a readily available market existed for such investments and those differences could be material.

The Foundation's investments that employ the practical expedient consist of all the alternative investments and certain equity investments, which are structured as partnerships, limited liability companies and offshore investment funds. These investments have restrictions on redemptions.

The investment strategy types and redemption details of these investments at December 31, 2017 are as follows:

	Fair value	Unfunded commitments	Redemption frequency	Redemption notice period
Equity investments (a)	$ 23,839,800	$ -	3 year lock-up	N/A
Multi strategy funds (b)	27,985,112	-	Annually	90 days
Other alternative funds (c)	16,924,637	7,175,000	None	N/A
	$ 68,749,549	$ 7,175,000		

The investment strategy types and redemption details of these investments at December 31, 2016 are as follows:

	Fair value	Unfunded commitments	Redemption frequency	Redemption notice period
Equity investments (a)	$ 18,621,700	$ -	3 year lock-up	N/A
Multi strategy funds (b)	27,478,900	-	Annually	90 days
Other alternative funds (c)	16,105,548	12,137,500	None	N/A
	$ 62,206,148	$ 12,137,500		

(a) This category consists of an offshore investment fund that invests in global public equities in a highly concentrated fashion. There is liquidity of 10% during years 1 and 2 and 7.5% during year 3, with remainder available to redeem at the end of the lock. 2.5% may be taken each quarter. Unused entitlement rolls from one quarter to the next, but does not roll from one year to the next.

(b) This category consists of two open-end funds. One invests in various strategies including investments in special situations, financially distressed issuers, convertible hedging and real estate. The other fund generally invests in noninvestment-grade credit instruments.

4. Fair value (continued):

(c) This category consists of various closed-end limited partnerships with finite lives up to 15 years, which do not permit redemption before termination. These investments consist of various debt related strategies including whole loan origination, commercial and residential mortgage backed securitized lending, European real estate and key facility corporate lease lending. Substantially all of the value of the investments in this category can never be redeemed with the funds. Instead, due to the nature of these investments, distributions are received through the liquidation of the underlying assets of the funds. It is estimated that the underlying assets will be liquidated over the next 10 years.

5. Line of credit:

The Foundation has a $5,000,000 uncollateralized revolving line of credit with a major commercial bank with interest at the daily one-month LIBOR (1.56% and .77% at December 31, 2017 and 2016) plus 1.5%. The line expires in February 2019 and is renewable annually. There were no borrowings, repayments, amounts outstanding on the line or interest expense incurred for the years ended December 31, 2017 and 2016.

6. Benefit plans:

Defined contribution pension plan:

The Foundation has a noncontributory defined contribution plan for all eligible employees. The Foundation makes fully vested contributions ranging from 10% - 15%, based on years of service. The Foundation incurred defined contribution plan expense of $142,985 and $142,300 for 2017 and 2016.

Flexible benefits plan:

The Foundation has a flexible benefits plan whereby it contributes 10% of compensation for eligible employees to be used for medical, retirement, education and other expenses. The Foundation contributed $103,134 and $134,390 to the plan for 2017 and 2016.

Postretirement benefits plan:

The Foundation maintains a postretirement benefit plan, which provides certain health care benefits to retired employees and their spouses, as defined by the plan. During 2006, the Foundation froze eligibility for participation in its postretirement benefit plan to those employees hired before June 1, 2005. The Foundation made contributions and the Plan paid benefits of $35,222 and $41,297 during 2017 and 2016.

7. Commitments and contingencies:

Large binocular telescope project:

The Foundation is a partner with a 12.5% interest in the Large Binocular Telescope Project, which is building and managing an astronomical observatory. The Foundation has sold or granted to other astronomy institutions, under various agreements, all of its viewing rights in the observatory along with the obligation to pay related operating costs associated with those rights. The Foundation remains liable for its proportionate share of observatory construction and certain other project development costs and has accrued its best estimate of these costs as LBT liability. The Foundation remains contingently liable for its proportionate share of future commissioning, operating and instrumentation costs, to the extent the institutions become unable to pay and forfeit their viewing rights or in the event these costs exceed any caps specified in the agreements with the institutions.

Operating leases:

The Foundation leases its office space under a noncancelable operating lease expiring in 2019. Rental expense was $224,631 and $236,807 in 2017 and 2016. In January 2016, the Foundation entered into an agreement to sublease a portion of its office space to a third party. In August 2017, this sublease agreement was terminated and the space was removed from the Foundation's responsibility through a lease amendment.

Future minimum rental payments under the lease at December 31, 2017 are as follows:

Year ending December 31,	
2018	$ 224,737
2019	229,293
	$ 454,030