RESEARCH CORPORATION FOR SCIENCE ADVANCEMENT

YEARS ENDED DECEMBER 31, 2018 AND 2017

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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, 2018 and 2017, and the related statements of activities, functional expenses, 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 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 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, 2018 and 2017, 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.

Emphasis of Matter

As discussed in Note 1 to the financial statements, in 2018, the Organization adopted Accounting Standards Update (ASU) 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. Our opinion is not modified with respect to this matter.

BeachFleischman PC

Tucson, Arizona
April 23, 2019

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RESEARCH CORPORATION FOR SCIENCE ADVANCEMENT

STATEMENTS OF FINANCIAL POSITION

DECEMBER 31, 2018 AND 2017

ASSETS

	2018	2017
Cash and cash equivalents	$ 2,940,455	$ 2,270,546
Investments	161,639,838	170,197,157
Other receivables	678,703	1,764,000
Other assets	207,698	247,859
Property and equipment, net of accumulated depreciation ($809,003, 2018; $799,920, 2017)	29,920	39,003
	$ 165,496,614	$ 174,518,565

LIABILITIES AND NET ASSETS

	2018	2017
Accounts payable and accrued expenses	$ 136,029	$ 74,490
Grants and awards payable	525,002	665,000
Postretirement benefit obligation	525,718	571,667
LBT liability	397,636	1,371,368
	1,584,385	2,682,525
Commitments and contingencies		
Net assets:		
Without donor restrictions	163,912,229	171,836,040
	$ 165,496,614	$ 174,518,565

See notes to financial statements.

RESEARCH CORPORATION FOR SCIENCE ADVANCEMENT

STATEMENTS OF ACTIVITIES

YEARS ENDED DECEMBER 31, 2018 AND 2017

	2018	2017
Changes in net assets without donor restrictions:		
Revenues and support:		
Net investment income (loss):		
Net capital gains (losses)	$ (2,718,026)	$ 25,854,767
Interest and dividend income	1,388,404	1,040,840
	(1,329,622)	26,895,607
Contributions	300,000	-
	(1,029,622)	26,895,607
Expenses:		
Program services	6,394,533	6,045,299
General and administrative	999,656	948,238
	7,394,189	6,993,537
Other income:		
Reduction in LBT liability	500,000	-
Change in net assets without donor restrictions	(7,923,811)	19,902,070
Net assets without donor restrictions, beginning	171,836,040	151,933,970
Net assets without donor restrictions, ending	$ 163,912,229	$ 171,836,040

See notes to financial statements.

RESEARCH CORPORATION FOR SCIENCE ADVANCEMENT

STATEMENT OF FUNCTIONAL EXPENSES

YEAR ENDED DECEMBER 31, 2018

	Program services					
	Grants and awards	Conferences and convening	Communications and outreach	Total program services	General and administrative	Total expenses
Grants and awards approved	$ 4,028,850	$ -	$ -	$ 4,028,850	$ -	$ 4,028,850
Salaries	428,528	184,464	239,574	852,566	477,883	1,330,449
Employee benefits	174,731	68,363	82,849	325,943	172,170	498,113
Conferences and meetings	39,472	703,577	37,590	780,639	121,059	901,698
Consultants and other expenses	80,986	10,224	84,336	175,546	96,835	272,381
Professional services	58,988	-	-	58,988	41,330	100,318
Rent and occupancy costs	92,866	39,942	39,193	172,001	87,624	259,625
Taxes	-	-	-	-	2,755	2,755
	$ 4,904,421	$ 1,006,570	$ 483,542	$ 6,394,533	$ 999,656	$ 7,394,189

See notes to financial statements.

RESEARCH CORPORATION FOR SCIENCE ADVANCEMENT

STATEMENT OF FUNCTIONAL EXPENSES

YEAR ENDED DECEMBER 31, 2017

	Program services					
	Grants and awards	Conferences and convening	Communications and outreach	Total program services	General and administrative	Total expenses
Grants and awards approved	$ 4,025,730	$ -	$ -	$ 4,025,730	$ -	$ 4,025,730
Salaries	438,022	121,136	152,904	712,062	402,110	1,114,172
Employee benefits	152,805	37,109	56,491	246,405	6,423	252,828
Conferences and meetings	69,541	505,890	31,681	607,112	147,003	754,115
Consultants and other expenses	123,720	8,134	93,447	225,301	261,728	487,029
Professional services	62,446	-	-	62,446	37,227	99,673
Rent and occupancy costs	97,548	34,696	33,999	166,243	88,085	254,328
Taxes	-	-	-	-	5,662	5,662
	$ 4,969,812	$ 706,965	$ 368,522	$ 6,045,299	$ 948,238	$ 6,993,537

See notes to financial statements.

RESEARCH CORPORATION FOR SCIENCE ADVANCEMENT

STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2018 AND 2017

	2018	2017
Cash flows from operating activities:		
Increase (decrease) in net assets	$ (7,923,811)	$ 19,902,070
Adjustments to reconcile increase (decrease) in net assets to net cash used in operating activities:		
Depreciation	9,083	9,083
Net realized and unrealized (gains) losses on investments	153,173	(28,677,182)
Reduction in LBT liability	(500,000)	-
Changes in operating assets and liabilities:		
Other receivables	1,085,297	(99,500)
Other assets	40,161	(18,594)
Accounts payable and accrued expenses	61,539	20,014
Grants and awards payable	(139,998)	105,000
Postretirement benefit obligation	(45,949)	(189,492)
LBT liability	(473,732)	(11,632)
Net adjustments	189,574	(28,862,303)
Net cash used in operating activities	(7,734,237)	(8,960,233)
Cash flows from investing activities:		
Purchases of investments	(12,437,500)	(10,462,501)
Proceeds from sale/maturity of investments	20,841,646	16,444,674
Net cash provided by investing activities	8,404,146	5,982,173
Net increase (decrease) in cash and cash equivalents	669,909	(2,978,060)
Cash and cash equivalents, beginning	2,270,546	5,248,606
Cash and cash equivalents, ending	$ 2,940,455	$ 2,270,546

See notes to financial statements.

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.

Net assets:

Net assets, revenues, gains, and losses are classified based on the existence or absence of donor or grantor imposed restrictions. Accordingly, net assets and changes therein are classified and reported as follows:

- *Net assets without donor restrictions* - Net assets available for use in general operations and not subject to donor restrictions.

- *Net assets with donor restrictions* - Net assets subject to donor-imposed time and/or purpose 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.

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

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.

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 3.

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, 2018 and 2017 consist of amounts owed to the Foundation from other 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.

Program 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).

From time to time, the Foundation may be subject to penalties and interest assessed by various taxing authorities, which are classified as general and administrative expenses, if they occur.

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

Change in accounting principle:

In August 2016, FASB issued Accounting Standards Update (ASU) 2016-14, "Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities." The update addresses the complexity and understandability of net asset classification, deficiencies in information about liquidity and availability of resources, and the lack of consistency in the type of information provided about expenses and investment return. The Organization has implemented ASU 2016-14 and has adjusted the presentation in these financial statements accordingly. The ASU has been applied retrospectively to all periods presented.

Subsequent events:

The Foundation's management has evaluated the events that have occurred subsequent to December 31, 2018 through April 23, 2019, 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 of financial assets:

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:

	2018	2017
Cash and cash equivalents	$ 2,940,455	$ 2,270,546
Investments (less outstanding commitments of $8,725,000 and $7,175,000)	87,622,617	94,272,608
Other receivables	678,703	1,014,300
	$ 91,241,775	$ 97,557,454

3. Investments and fair value measurements:

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 management firms. The cost presented in the following table consists of cash invested less cash returned.

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.

3. Investments and fair value measurements (continued):

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.

At December 31, 2018, the Foundation's investments consist of the following (in thousands):

	Cost	Fair value	Practical expedient	Level 1	Unfunded commitments	Redemption frequency	Redemption notice period
Global equity:							
Mutual funds	$ 55,502	$ 68,471	$ -	$ 68,471	$ -		
Equity investment funds (a)	17,000	23,838	23,838	-	-	3-year lock	N/A
Private equity fund	-	-	-	-	5,000	None	N/A
Global fixed income:							
Money market funds	28,176	27,877	-	27,877	-		
Limited partnerships (c)	6,354	9,469	9,469	-	2,225	None	N/A
Diversifying strategy:							
Open-ended multi strategy fund (b)	2,000	24,283	24,283	-	-	Annually	90 days
Real assets:							
Limited partnership (c)	4,916	7,702	7,702	-	1,500	None	N/A
	$ 113,948	$ 161,640	$ 65,292	$ 96,348	$ 8,725		

3. Investments and fair value measurements (continued):

At December 31, 2017, the Foundation's investments consist of the following (in thousands):

	Cost	Fair value	Practical expedient	Level 1	Unfunded commitments	Redemption frequency	Redemption notice period
Global equity:							
Mutual funds	$ 58,734	$ 79,399	$ -	$ 79,399	$ -		
Equity investment funds (a)	17,000	23,840	23,840	-	-	3-year lock	N/A
Global fixed income:							
Money market fund	22,176	22,048	-	22,048	-	-	-
Limited partnerships (c)	8,416	13,639	13,639	-	4,600	None	N/A
Diversifying strategy:							
Open-ended multi-strategy fund (b)	2,000	23,285	23,285	-	-	Annually	90 days
Real assets:							
Limited partnership (c)	6,407	7,986	7,986	-	2,575	None	N/A
	$ 114,733	$ 170,197	$ 68,750	$ 101,447	$ 7,175		

(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 an open-end fund which invests in various strategies including investments in special situations, financially distressed issuers, convertible hedging and real estate.

(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.

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

Net capital gains (losses) consists of the following:

	2018	2017
Net realized and unrealized gains (losses) on investments	$ (153,173)	$ 28,677,182
Investment advisory fees	(2,370,725)	(2,624,861)
Internal investment management costs	(194,128)	(197,554)
	$ (2,718,026)	$ 25,854,767

4. 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 (2.52% and 1.56% at December 31, 2018 and 2017) plus 1.5%. The line expires in February 2020 and is renewable annually. There were no borrowings, repayments, amounts outstanding on the line or interest expense incurred for 2018 and 2017.

5. Benefit plans:

Defined contribution plan:

The Foundation has a noncontributory defined contribution plan for all eligible employees. The Foundation makes fully vested contributions ranging from 10% - 15% of compensation, based on years of service. The Foundation incurred defined contribution plan expense of $148,775 and $142,985 for 2018 and 2017.

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 $132,784 and $103,134 to the plan for 2018 and 2017.

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 $45,950 and $35,222 during 2018 and 2017.

6. 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. Effective January 1, 2019, the Foundation has executed an agreement to transfer its 12.5% interest in the LBT to The Ohio State University (OSU) along with the obligation of assuming the viewing rights contracts with the other astronomy institutions. OSU and three of the other four astronomy institutions have signed agreements recognizing the transfer and relieving the Foundation of any further obligation. It is anticipated that the LBT will recognize the transfer at its Spring Meeting. Until the last astronomy organization has signed new agreements, the Foundation will remain contingently liable under that institution's original contracts.

Operating leases:

The Foundation leases its office space under a noncancelable operating lease expiring in 2024. Rental expense was $224,737 and $224,631 in 2018 and 2017.

6. Commitments and contingencies (continued):

Operating leases (continued):
Future minimum rental payments under the lease at December 31, 2018 are as follows:

Year ending December 31,	
2019	$ 210,763
2020	211,021
2021	211,285
2022	217,436
2023	223,757
Thereafter	230,248
	$ 1,304,510

7. Pending pronouncement:

In February 2016, the FASB issued ASU 2016-02 "Leases." ASU 2016-02 requires a lessee to recognize in the statement of financial position a liability to make lease payments and a right-of-use asset representing its right to use the underlying asset for the lease term, along with additional qualitative and quantitative disclosures. ASU 2016-02 is effective for reporting periods beginning after December 15, 2019, with early adoption permitted.

Management is currently evaluating the effect that this standard will have on the financial statements.

8. Reclassifications:

The 2017 financial statements have been reclassified in order to conform to the 2018 financial statement presentation. The reclassifications had no effect on net assets at December 31, 2018 or on changes in net assets for the year then ended.