Research Corporation

Financial Statements

As of and for the Years Ended December 31, 2006 and 2005

Index to Financial Statements

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Independent Auditors' Report

To the Board of Directors
Research Corporation

We have audited the accompanying statements of financial position of Research Corporation (the "Foundation") as of December 31, 2006 and 2005, and the related statements of activities and changes in net assets, and of cash flows for the years then ended. These financial statements are the responsibility of the Foundation's management. 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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, the financial statements referred to above present fairly, in all material respects, the financial position of Research Corporation as of December 31, 2006 and 2005, 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.

Keegan, Linscott & Kenon, P.C.

Tucson, Arizona
March 30, 2007

Statements of Financial Position
As of December 31,

	2006	2005
Assets:		
Investments:		
Common Trust Fund	$ 102,272,600	$ 93,033,170
Other investments	37,708,307	28,028,401
Program-related investment in Research Corporation Technologies, Inc.	25,000,000	25,000,000
Total investments	164,980,907	146,061,571
Cash and cash equivalents	-	663,103
Accrued dividends and interest receivable	226,938	328,282
Other receivables	741,816	828,876
Notes receivable	2,218,240	5,986,437
Property and equipment, net	412,997	491,697
Interest in LLC	1,878,277	1,951,071
Prepaid pension cost	629,825	914,468
Other assets	282,433	67,525
Total assets	$ 171,371,433	$ 157,293,030
Liabilities and net assets:		
Liabilities:		
Line of credit	$ 2,285,851	$ -
Accounts payable and accrued expenses	602,403	355,256
LSST liability	2,732,000	-
Grants payable	5,160,538	4,747,679
Note payable	1,213,611	1,294,925
LBT liability	1,801,912	1,427,766
Postretirement pension liability	1,021,678	957,253
Total liabilities	14,817,993	8,782,879
Net assets, unrestricted	156,553,440	148,510,151
Total liabilities and net assets	$ 171,371,433	$ 157,293,030

Statements of Activities and Changes in Net Assets
For the Years Ended December 31,

	2006	2005
Revenues:		
Unrestricted revenues:		
Net realized and unrealized gains and losses on investments	$ 18,188,005	$ 13,441,221
Interest and dividends, net	1,797,185	1,941,280
Interest income from program-related investments	1,750,000	1,750,000
Gain on interest in LLC	152,205	153,205
Other interest and miscellaneous income	358,968	107,780
Total unrestricted revenues	22,246,363	17,393,486
Expenses:		
Unrestricted expenses:		
Grants approved	6,046,102	5,622,515
Science advancement	1,490,038	1,387,258
Program-related	4,800,000	1,886,076
Information and communications	185,982	225,401
General and administrative	1,367,825	1,329,656
Interest	123,828	113,137
Tax expense	189,299	7,121
Total unrestricted expenses	14,203,074	10,571,164
Increase in net assets	8,043,289	6,822,322
Net assets at beginning of year	148,510,151	141,687,829
Net assets at end of year	$ 156,553,440	$ 148,510,151

Statements of Cash Flows
For the Years Ended December 31,

	2006	2005
Cash flows from operating activities:		
Increase in net assets	$ 8,043,289	$ 6,822,322
Adjustments to reconcile increase in net assets to net cash used in operating activities:		
Net realized gains on sales of common trust fund	(10,995,155)	(12,258,214)
Unrealized appreciation (depreciation) of common trust fund	(3,244,275)	2,289,011
Unrealized appreciation of other investments	(3,948,575)	(3,472,018)
Earnings on interest in LLC	(152,205)	(153,205)
Non-cash expense item	(165,151)	113,634
Depreciation and amortization	78,700	57,000
Change in operating assets and liabilities:		
Restricted cash	-	1,028,880
Accrued dividends and interest receivable	101,344	(11,270)
Other receivables	87,060	(828,876)
Prepaid pension cost	284,643	229,312
Other assets	(214,908)	(3,000)
LBT liability	374,146	1,095,766
Grants payable	412,859	191,436
Accounts payable and accrued expenses	247,147	22,169
Accrued LSST Obligation	2,732,000	-
Postretirement pension liability	64,425	66,815
Net cash used in operating activities	(6,294,656)	(4,810,238)
Cash flows from investing activities:		
Proceeds from sale of common trust fund investments	5,000,000	12,000,000
Purchase of other investments	(9,262,500)	(8,300,000)
Distributions received from other investments	3,531,169	5,392,619
Advances on notes receivable	(70,524)	(48,849)
Distributions received from LLC	225,000	220,000
Proceeds received from repayments on notes receivable	4,003,871	1,657,086
Purchases of property and equipment	-	(124,652)
Net cash provided by investing activities	3,427,016	10,796,204
Cash flows from financing activities:		
Borrowings on line of credit	8,892,773	3,108,632
Repayments on line of credit	(6,606,922)	(7,608,632)
Repayments on note payable	(81,314)	(941,201)
Net cash provided by (used in) financing activities	2,204,537	(5,441,201)
Net increase in cash and cash equivalents	(663,103)	544,765
Cash and cash equivalents at beginning of year	663,103	118,338
Cash and cash equivalents at end of year	$ -	$ 663,103
Supplemental disclosure of cash flow information:		
Cash paid during the year for interest	$ 140,197	$ 66,379
Cash paid during the year for taxes	$ 189,299	$ 7,121

The accompanying notes are an integral part of the financial statements

NOTES TO FINANCIAL STATEMENTS

1. Organization

Research Corporation (the "Foundation") is a private operating foundation incorporated in the State of New York. The Foundation is dedicated to the advancement of science.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with standards set forth in Statement of Financial Accounting Standards SFAS No. 117, *Financial Statements of Not-for-Profit Organizations* and the AICPA audit and accounting guide, *Not-for-Profit Organizations*.

The Foundation is required under generally accepted accounting principles to report 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.

All contributions are considered to be available for unrestricted use unless specifically restricted by the donor. Amounts received that are designated for future periods or restricted by the donor for specific purposes are reported as temporarily restricted support. However, if a restriction is fulfilled in the same time period in which the contribution is received, the Foundation reports the support as unrestricted. Contributions of long-lived assets not having donor imposed time or purpose restrictions are reported as unrestricted contributions in amounts equal to the fair market value of the contributed asset.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, demand deposits, savings accounts and highly liquid debt investments purchased with an original maturity of three months or less that are not carried in the Foundation's portfolio of investments.

The Foundation places its cash and cash equivalents with high credit quality institutions. At times, such investments may be in excess of the FDIC insurance limit; however, management does not believe it is exposed to any significant credit risk on cash and cash equivalents.

Common Trust Fund

The Foundation carries its investments in the common trust fund at fair market value. Realized gains and losses are computed based on the difference between the net proceeds received and cost at time of acquisition using the average cost method. Unrealized net appreciation or depreciation of investments in the common trust fund represents the change in the difference between acquisition cost and current market value at the beginning of the year versus the end of the year, and is recognized currently in the statement of activities and changes in net assets.

Other Investments

Other investments consisting of unconsolidated limited partnership interests are recorded at estimated fair value in accordance with SFAS No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*. Investments in limited partnerships are valued at the quoted market price for securities for which market quotations are readily available or estimated fair value as determined in good faith by the general partner. The cost of investments sold is determined using the specific identification method. Other than temporary impairments are recognized in the period in which they occur.

NOTES TO FINANCIAL STATEMENTS

Summary of Significant Accounting Policies (continued)

Interest in LLC
The Foundation's interest in a limited liability company ("LLC") is accounted for under the equity method of accounting, which provides for recognition of the Foundation's proportionate share of the limited liability company's income or loss in its statement of activities and changes in net assets with any distributions received reported as a reduction in the Foundation's interest in the LLC.

Property and Equipment
Property and equipment are stated at cost. Depreciation is calculated using the straight-line method over estimated useful lives as follows:

Tenant improvements	10 years
Furniture, fixtures and equipment	5 years
Software	5 years

Maintenance and repairs are charged to expense as incurred. Major renewals and improvements are capitalized.

Grants Payable
The Foundation accounts for unconditional promises to give, which is normally in the form of grants, as an expense in the year the unconditional promise is made and approved by the Board of Directors, and unpaid promises to give are reported as grants payable.

Revenue Recognition
Interest income is recorded as earned; dividends are accrued as of the ex-dividend date.

Income Taxes
The Foundation qualifies as a tax-exempt private operating foundation under Internal Revenue Code Section 4940(d).

Use of Estimates
The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities 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.

Fair Value of Financial Instruments
The carrying amounts of financial instruments, including cash, cash equivalents, accounts receivable, accounts payable and other accrued expenses approximates fair value due to the short maturity of these instruments.

Investment Risk
The Foundation utilizes various investment instruments. Investment securities, in general, are exposed to various risks, such as interest rate, credit and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the statement of financial position.

Reclassifications
Certain December 31, 2005 balances have been reclassified to conform to the December 31, 2006 presentation.

Notes to Financial Statements

Summary of Significant Accounting Policies (continued)

New Pronouncement

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*. This statement requires employers to recognize the funded status of a benefit plan in the balance sheet and recognize changes in the funded status through comprehensive income. In addition, it requires plan assets and obligations to be measured as of the balance sheet date along with other disclosures. Employers without publicly traded equity securities are required to recognize the funded status of a defined postretirement plan and provide the related disclosures as of the end of the fiscal year ending after June 15, 2007. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. The Foundation believes that this new pronouncement will not have a significant impact on its financial condition.

3. Investments

A. Common Trust Fund

The Foundation invests in various special purpose funds within the Capital Guardian Common Trust Fund (the "Trust"). The Trust operates as a mutual fund invested in marketable securities and is available only to participants that are exempt from taxation under Internal Revenue Code of 1986 and are qualified institutional buyers and qualified purchasers as defined by applicable securities rules.

Investments consist of the following as of December 31:

	2006		2005	
	Market Value	Cost	Market Value	Cost
Capital Guardian Trust Funds:				
Global Equity Fund	$ 76,147,573	$ 55,515,711	$ 67,204,283	$ 49,319,295
Emerging Markets Growth Fund	11,596,088	10,708,463	8,682,955	7,906,399
Absolute Income Grower	10,568,940	9,391,723	6,849,283	6,583,103
U. S. Value Equity Fund	3,959,999	3,402,195	10,296,649	9,214,140
Total	$ 102,272,600	$ 79,018,092	$ 93,033,170	$ 73,022,937

Net gain on investments consist of the following for the year ended December 31:

	2006	2005
Net realized gain on sales of investments	$ 10,995,155	$ 12,258,214
Unrealized net appreciation/(depreciation) of investments	3,244,275	(2,289,011)
Net gain on marketable investments	$ 14,239,430	$ 9,969,203

Proceeds from sale of investments were either reinvested, used to fund purchases of other investments, used to repay line of credit borrowings or to pay grants payable.

Investment fees incurred for the year ended December 31, 2006 and 2005 were $299,909 and $295,445, respectively. These fees are reported as a reduction of investment interest and dividend income in the statement of activities.

Notes to Financial Statements

B. Other Investments

Other investments, at estimated fair value, consist of the following as of December 31:

	2006	2005
Angelo Gordon Super Fund L.P.	$ 20,200,463	$ 17,658,369
Angelo Gordon Real Estate Strategies	9,515,641	8,671,989
Angelo Gordon Credit Strategies	7,992,203	1,698,043
Total other investments	$ 37,708,307	$ 28,028,401

Annual activity for other investments consists of the following for the year ended December 31, 2006:

	AG Super Fund	AG Real Estate Strategies	AG Credit Strategies	Total 2006
Opening balance	$ 17,658,369	$ 8,671,989	$ 1,698,043	$ 28,028,401
Capital contributions	-	2,712,500	6,550,000	9,262,500
Distributions	-	(3,012,500)	(518,669)	(3,531,169)
Appreciation	2,542,094	1,143,652	262,829	3,948,575
Ending balance	$ 20,200,463	$ 9,515,641	$ 7,992,203	$ 37,708,307

At December 31, 2006 the Foundation was committed to additional funding in the form of capital contributions of $6,687,500 in the above investment funds.

C. Program-Related Investment in Research Corporation Technologies, Inc.

On March 2, 1987, as amended on March 25, 1994, in accordance with Section 1605(c) of the Tax Reform Act of 1986, the Foundation and Research Corporation Technologies, Inc. (“RCT”), a nonprofit corporation subject to regular corporate income tax laws, entered into agreements through which RCT assumed responsibility for the Technology Transfer Program (the “Program”), which the Foundation had operated for many years. In addition to the transfer of the Program, the Foundation transferred $35,000,000 in cash and securities in exchange for a $35,000,000 fully subordinated unsecured note from RCT (the “Note”) due February 28, 2017.

RCT has prepaid $10,000,000 of the Note, and the remaining $25,000,000 principal amount of the amended Note is due on February 28, 2017, subject to acceleration at the option of the Foundation after December 31, 2012, provided RCT’s retained earnings exceed $100,000,000. Interest at the rate of 7% per annum on the outstanding principal amount is due semiannually.

To qualify as a program-related investment under Section 4944(c) of the Tax Reform Act of 1986, the terms of the loan were required to be less than prevailing terms. In addition, this investment is a vehicle for the Foundation to continue one of its charter purposes, the furthering of technology. As there are no comparable alternative program-related investments available to the Foundation, the Foundation believes it is not practicable to estimate the fair value of this investment.

Notes to Financial Statements

4. Notes Receivable

Notes receivable as of December 31:

	2006	2005
Note receivable from Exeter Life Sciences, Inc., bearing interest at LIBOR plus 2% (7.26% at December 31, 2006). Annual principal and quarterly interest payments are due in accordance with the terms of the agreement. Guaranteed by a high net worth individual. Matures January 2007. The note maturity was extended through June 30, 2007 and the interest was revised to prime plus 1% (9.25% at December 31,2006).	$ 1,250,000	$ 2,250,000
Note receivable from the University of Minnesota, with an original amount of $5,000,000, interest imputed at a rate of 3.375%. Annual principal and interest payments are due every February of $1,000,000. Matures February 2007. In the event of default the viewing rights revert back to the Foundation.	968,240	1,899,532
Note receivable from the University of Virginia, with an original amount of $4,000,000, interest imputed at a rate of 3.375%. Annual principal and interest payments are due every October of $800,000. In the event of default the viewing rights revert back to the Foundation.	-	1,511,786
Other, secured by real estate	-	325,119
Total notes receivable	$ 2,218,240	$ 5,986,437

5. Property and Equipment

Property and equipment consist of the following as of December 31:

	2006	2005
Tenant improvements	$ 376,776	$ 376,776
Furniture, fixtures and equipment	163,978	163,978
Software	108,401	108,401
	649,155	649,155
Less accumulated depreciation	236,158	157,458
Property and equipment, net	$ 412,997	$ 491,697

Depreciation expense was $78,700 and $57,000 for the years ended December 31, 2006 and 2005, respectively.

NOTES TO FINANCIAL STATEMENTS

6. Interest in LLC

The Foundation has a 50% interest in 4703 Camp Lowell, LLC, an Arizona Limited Liability Company (the "LLC"), whose principal activity is ownership of the office building, which the Foundation partially utilizes for its operations (see Note 9). At December 31, 2006, the Foundation recognized income of $152,205 which represents its proportionate share of the LLC's 2006 net income. The Foundation received $225,000 in cash distributions from the LLC during 2006.

A condensed summary of the LLC's balance sheet and income statement as of and for the years ended December 31, 2006 and 2005 are summarized below:

	2006	2005
Balance Sheet		
Assets:		
Current assets	$ 48,779	$ 56,793
Land, property and equipment, net	3,649,527	3,743,587
Other assets	144,725	165,572
Total assets	$ 3,843,031	$3,965,952
Liabilities and Partners' Equity:		
Current liabilities	86,478	63,810
Partners equity	3,756,553	3,902,142
Total liabilities and partners' equity	$ 3,843,031	$ 3,965,952
Income Statement		
Operating income	$ 700,647	$ 663,141
Operating expense	278,026	218,811
Net operating income	422,621	444,330
Depreciation and amortization	114,907	134,198
Other expense	3,304	3,723
Net income	$ 304,410	$ 306,409

7. Note Payable

In 2001, Research Corporation entered into a note payable agreement with the University of Arizona in the amount of $3,000,000 for viewing nights at certain telescopes owned by the University of Arizona. The note is non-interest bearing and is payable in proportion to amounts received on its notes receivable from the University of Minnesota and University of Virginia (see Note 4). Interest has been imputed on the note at a rate of 3.375%. Amount outstanding on the note payable as of December 31, 2006 and 2005 is $1,213,611 and $1,294,295, respectively. Interest expense is $23,083 and $40,791 for the years ended December 31, 2006 and 2005, respectively.

Notes to Financial Statements

8. Line of Credit

The Foundation has a $15,000,000 uncollateralized revolving line of credit with interest at LIBOR plus 1.0% (6.33% at December 31, 2006). At December 31, 2006, borrowings against the line of credit totaled $2,285,851. There were no borrowings against the line of credit at December 31, 2005. The Foundation incurred interest expense of $100,745 and $72,346 for the years ended December 31, 2006 and 2005, respectively, which is reported in interest and other expense.

The revolving line of credit agreement contains certain covenants, the most restrictive of which require the Foundation to maintain a tangible net worth of $110 million as defined by the agreement.

9. Operating Leases

The Foundation leases approximately 33% of 4703 Camp Lowell, LLC, a related party (see Note 6), under a 10-year non-cancelable operating lease. The Foundation believes rent under the operating lease is at fair value and is comparable to what could be obtained with a third party. In March 2004, the Foundation entered into an arrangement to lease an additional 17% of the building and sublet the additional space at identical terms to the LSST Corporation, a related party. Rental expense was $238,175 and $224,133 in 2006 and 2005, respectively.

Future minimum rental payments under the lease and sublease as of December 31, 2006 are as follows:

	Original Lease	Sublease
2007	$ 209,610	$ 104,400
2008	209,610	104,400
2009	209,610	104,400
2010	209,610	104,400
2011	209,610	104,400
Thereafter	419,220	208,800
Total	$ 1,467,270	$ 730,800

Pursuant to its sublease, the Foundation holds a $202,050 rent deposit from LSST.

10. Related Party Transactions

LSST Project

LSST Corporation was formed to build a large-aperture synoptic survey telescope. The LSST Corporation is a 501 (c)(3) organization made up of universities and other not-for-profit organizations focused on astronomy, of which the Foundation is a 1/16th member. During the years ended December 31, 2006 and 2005 Research Corporation contributed approximately $974,000 and $685,000 to LSST. As of December 31, 2006, the Foundation committed additional funding and consequently has a payable to LSST (a related party) for $2,732,000, the aggregate amount of the unpaid commitment. There was no payable balance to LSST as of December 31, 2005.

NOTES TO FINANCIAL STATEMENTS

11. Pension Plan and Postretirement Benefits

In 2006, the Foundation froze entry into its noncontributory defined benefit pension plan to all employees hired after June 1, 2006.

Defined Contribution Pension Plan
The Foundation maintains a noncontributory defined contribution plan, eligible to all employees hired after June 1, 2005 who have completed one year of employment. The Foundation makes fully vested contributions ranging from 10% - 15%, based on years of experience, for all participating employees. The Foundation incurred defined contribution plan expenses of $10,850 for the year ended December 31, 2006.

Defined Benefit Pension Plan
The Foundation maintains a noncontributory defined benefit pension plan (the "Plan"), which covers 70% of its employees at the 2006 measurement date. The benefits provided by the Plan are generally based on years of service and employees' salary history. It is the Foundation's policy to contribute amounts sufficient to at least meet the Employee Retirement Income Security Act's minimum funding requirements. The Foundation expects not to contribute to the Plan in 2007 due to its funding status.

The measurement date of the plan is September 30th based on employee census information provided as of the beginning of the year, January 1st. All Plan assets were fully invested in a balanced mutual fund as of December 31, 2006 and 2005, which is consistent with the Foundation's investment policy.

The following table sets forth the funded status and amounts recognized in the Foundation's accompanying statement of financial position as of December 31:

	2006	2005
Projected benefit obligation	$ (1,321,960)	$ (1,595,914)
Plan assets at fair value	1,726,335	1,583,404
Funded status	404,375	(12,510)
Unrecognized net (gain) loss	(134,546)	534,217
Unrecognized prior service cost	417,995	450,001
Adjustment for net pension cost September 30 - December 31	(57,999)	(57,240)
Prepaid pension cost	$ 629,825	$ 914,468

Assumptions used in the accounting for the pension plan as of December 31:

	2006	2005
Discount rate	5.750%	5.375%
Rate of increase in compensation levels	4.25%	4.25%
Expected long-term rate of return on assets	7.50%	7.50%

NOTES TO FINANCIAL STATEMENTS

Pension Plan and Postretirement Benefits (continued)

The expected long-term rate of return on assets was based on expected future rates of return and average historical returns.

Pertinent information related to pension benefits for the pension plan is as follows:

	2006	2005
Accumulated benefit obligation	$ 1,046,776	$ 1,081,373
Net periodic benefit cost	284,643	228,959
Foundation contributions	-	-
Benefits paid	-	227,451

Benefits payments expected to be paid in each of the next five fiscal years, and in the aggregate for the next five fiscal years are as follows:

2007	$ 17,361
2008	61,183
2009	61,670
2010	62,011
2011	62,184
2012 through 2016	614,695
Total	$ 879,104

Postretirement Plan

During the year ended December 31, 2006, the Foundation froze eligibility for participation in its postretirement plan to those employees hired before June 1, 2005.

In addition to providing pension benefits, the Foundation provides certain health care benefits to retired employees and their spouses. Approximately 30% of the Foundation's employees may become eligible for these benefits if they reach normal retirement age while working for the Foundation. Estimated contributions to the plan for 2007 are $119,000.

The measurement date of the Plan is September 30th based on employee census information as of the beginning of the year, January 1st.

Notes to Financial Statements

Pension Plan and Postretirement Benefits (continued)

A reconciliation of the accumulated postretirement benefit obligation to the liability recognized in the statements of financial position is as follows:

	2006	2005
Accumulated benefit obligation	$ (1,226,667)	$ (1,274,122)
Plan assets at fair value	-	-
Funded status	(1,226,667)	(1,274,122)
Unrecognized net gain subsequent to transition	(477,320)	(441,252)
Unrecognized transition obligations	682,309	758,121
Accrued postretirement benefit liability	$ (1,021,678)	$ (957,253)

Pertinent information related to benefits for the plan is as follows:

	2006	2005
Net periodic benefit cost	$ 123,061	$ 123,115
Foundation contributions	$ 58,636	$ 56,300
Benefits paid	$ 58,636	$ 56,300

Benefits payments expected to be paid in each of the next five fiscal years, and in the aggregate for the next five fiscal years are as follows:

2007	$ 119,070
2008	131,219
2009	129,809
2010	130,244
2011	146,711
2012 through 2016	459,046
Total	$ 1,116,099

The actuarial calculations in 2006 and 2005 assume a dental inflation assumption of 4.5% and a medical inflation assumption of 7.9375% decreasing uniformly to 4.5% over 4 years. The assumed discount rate is 5.375% for 2006 and 2005.

The health care cost trend rate assumptions impact the service and interest cost and the accumulated benefit obligation. A 1% increase in these rates would increase service and interest cost by approximately $11,000 and the accumulated benefit obligation by approximately $92,000, while a 1% decrease would decrease service and interest cost by approximately $10,000 and decrease the accumulated benefit obligation by approximately $78,000.

Notes to Financial Statements

Pension Plan and Postretirement Benefits (continued)

During the year ended December 31, 2006, the Foundation established a flexible benefits plan whereby it will contribute 10% of employee compensation on behalf of employees to be used for medical, retirement, education and other expenses. Employees hired after June 1, 2005 are automatically enrolled in the new plan after completion of three months service. Employees hired before June 1, 2005 who chose to elect out of the postretirement plan are eligible for this new plan.

12. Commitments and Contingencies

Large Binocular Telescope ("LBT") Project

The Foundation is a partner with a 12.5% interest in the Large Binocular Telescope Project (the "Project"), which is building and managing an astronomical observatory. The Foundation has sold or granted to other astronomy research institutions (the "Institutions") all of its viewing rights in the observatory along with the obligation to pay related operating costs under various agreements. The Foundation remains liable for its proportionate share of observatory construction costs and has accrued its best estimate of these costs.

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 agreement with the Institutions. In addition, the Foundation's agreements with certain of the Institutions contain an escape clause, which would allow those Institutions the right to rescind the agreement and recover all payments made. In the event that occurs, the Foundation would re-assume the viewing rights forfeited and be liable for future commissioning, operating and instrumentation costs. Management believes that such Institutions would exercise their escape clause only in the event the Project does not achieve its scientific objectives, the likelihood of which Management believes is highly unlikely.

The Institutions with an escape clause in their agreements have made combined payments of $8.4 million in capital and operating payments through December 31, 2006. Such Institutions also had outstanding notes receivable and operating expense payments due of $1.3 million at December 31, 2006.

Excise Taxes

During 2003, the Foundation terminated a pension plan, and replaced it with their current Plan, the Research Corporation Employee's Replacement Plan (the "Replacement Plan"). Accumulated benefits totaling approximately $3,600,000 under the Plan were paid out to participants. The remaining Plan assets of $5,061,653 reverted to the Foundation, of which $1,470,818 was contributed to fund the Replacement Plan. In 2005, the Internal Revenue Service ("IRS") sent Research Corporation a draft verification of facts letter that the Foundation might owe approximately $879,000 in additional excise tax with respect to the reversion, plus interest and penalties. The management of the Foundation in consultation with its external legal counsel believes they are exempt from the reversion tax and notified the IRS of such. The draft verification has not been finalized by the IRS.

Litigation

The Foundation is involved in legal proceedings in the normal course of its business operations. The Foundation does not believe that any pending or threatened proceeding would have a material adverse effect on its financial position or results of operations.