Report of Independent Auditors and
Financial Statements for

The Salk Institute for Biological Studies

June 30, 2015 and 2014

MOSS-ADAMS LLP

Certified Public Accountants | Business Consultants

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REPORT OF INDEPENDENT AUDITORS

The Board of Trustees
The Salk Institute for Biological Studies

Report on Financial Statements

We have audited the accompanying financial statements of The Salk Institute for Biological Studies, which comprise the statements of financial position as of June 30, 2015 and 2014, and the related statements of activities and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity'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 obtained is sufficient and appropriate to provide a basis for our audit opinion.

MOSS ADAMS LLP

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Salk Institute for Biological Studies as of June 30, 2015 and 2014, and the changes in net assets and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Moss Adams LLP

San Diego, California
September 30, 2015

THE SALK INSTITUTE FOR BIOLOGICAL STUDIES
STATEMENTS OF FINANCIAL POSITION
JUNE 30, 2015 AND 2014
(IN THOUSANDS)

	June 30,	
	2015	2014
ASSETS		
Cash and cash equivalents	$ 4,073	$ 14,933
Receivables and other assets, net	13,022	12,757
Contributions receivable, net	37,235	40,730
Funds held by trustees	26,759	12,286
Investments	326,948	319,247
Property, net	75,233	77,407
Total assets	$ 483,270	$ 477,360
LIABILITIES AND NET ASSETS		
Liabilities		
Accounts payable and accrued expenses	$ 21,412	$ 15,682
Unexpended advances	26,593	24,723
Retirement obligations	6,594	5,899
Debt	51,652	52,099
Total liabilities	106,251	98,403
Commitments and Contingencies (Note 10)		
Net Assets		
Unrestricted	100,070	106,869
Temporarily restricted	104,439	104,742
Permanently restricted	172,510	167,346
Total net assets	377,019	378,957
Total liabilities and net assets	$ 483,270	$ 477,360

See accompanying notes.

THE SALK INSTITUTE FOR BIOLOGICAL STUDIES
STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2015
(IN THOUSANDS)

	Unrestricted	Temporarily Restricted	Permanently Restricted	2015 Total
REVENUES, GAINS, AND OTHER SUPPORT				
Grants	$ 76,684	$ -	$ -	$ 76,684
Contributions	3,159	19,348	5,164	27,671
Other	7,769	-	-	7,769
Investment return designated for current operations	4,996	7,102	-	12,098
Net assets released from restrictions	21,194	(21,194)	-	-
Total revenues, gains, and other support	113,802	5,256	5,164	124,222
EXPENSES				
Research	99,178	-	-	99,178
Management and general	12,188	-	-	12,188
Fundraising	4,880	-	-	4,880
Total expenses	116,246	-	-	116,246
EXCESS (DEFICIENCY) OF REVENUES, GAINS, AND OTHER SUPPORT OVER EXPENSES	(2,444)	5,256	5,164	7,976
INVESTMENT LOSS IN EXCESS OF AMOUNT DESIGNATED FOR CURRENT OPERATIONS UNDER SPENDING POLICY	(3,832)	(5,559)	-	(9,391)
POST-RETIREMENT BENEFIT CHANGES OTHER THAN NET PERIODIC BENEFIT COST	(523)	-	-	(523)
CHANGE IN NET ASSETS	(6,799)	(303)	5,164	(1,938)
NET ASSETS				
Beginning of year	106,869	104,742	167,346	378,957
End of year	$ 100,070	$ 104,439	$ 172,510	$ 377,019

 See accompanying notes.

THE SALK INSTITUTE FOR BIOLOGICAL STUDIES
STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2014
(IN THOUSANDS)

	Unrestricted	Temporarily Restricted	Permanently Restricted	2014 Total
REVENUES, GAINS, AND OTHER SUPPORT				
Grants	$ 86,247	$ -	$ -	$ 86,247
Contributions	4,300	14,205	28,237	46,742
Other	7,579	-	-	7,579
Investment return designated for current operations	4,426	6,214	-	10,640
Net assets released from restrictions	16,456	(16,456)	-	-
Total revenues, gains, and other support	119,008	3,963	28,237	151,208
EXPENSES				
Research	103,169	-	-	103,169
Management and general	11,752	-	-	11,752
Fundraising	5,112	-	-	5,112
Total expenses	120,033	-	-	120,033
EXCESS (DEFICIENCY) OF REVENUES, GAINS, AND OTHER SUPPORT OVER EXPENSES	(1,025)	3,963	28,237	31,175
INVESTMENT RETURN IN EXCESS OF AMOUNT DESIGNATED FOR CURRENT OPERATIONS UNDER SPENDING POLICY	16,231	21,080	-	37,311
CHANGE IN NET ASSETS	15,206	25,043	28,237	68,486
NET ASSETS				
Beginning of year	91,663	79,699	139,109	310,471
End of year	$ 106,869	$ 104,742	$ 167,346	$ 378,957

THE SALK INSTITUTE FOR BIOLOGICAL STUDIES
STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2015 AND 2014
(IN THOUSANDS)

	Years Ended June 30, 2015	Years Ended June 30, 2014
OPERATING ACTIVITIES		
Change in net assets	$ (1,938)	$ 68,486
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	11,860	12,033
Contributions restricted for long-term assets	(3,619)	(5,483)
Net loss (gain) on investments and funds held by trustees	220	(48,501)
Changes in assets and liabilities:		
Receivables and other assets	(265)	9
Contributions receivable	(3,216)	(24,457)
Accounts payable and accrued expenses	5,730	(779)
Unexpended advances	1,870	(2,353)
Retirement obligations	695	66
Net cash provided by (used in) operating activities	11,337	(979)
INVESTING ACTIVITIES		
Purchases of property	(9,641)	(4,511)
Purchases of investments	(29,754)	(96,666)
Proceeds from sales of investments	21,702	89,467
Net cash used in investing activities	(17,693)	(11,710)
FINANCING ACTIVITIES		
Proceeds from contributions restricted for:		
Investment in perpetuity	9,530	12,987
Investment in plant	800	(50)
Debt issuance costs	(457)	-
Debt proceeds	1,635	-
Payments on debt	(1,670)	(1,605)
Additions to funds held by trustees	(18,532)	(410)
Proceeds from sale of funds held by trustees	4,190	184
Net cash (used in) provided by financing activities	(4,504)	11,106
NET DECREASE IN CASH AND CASH EQUIVALENTS	(10,860)	(1,583)
CASH AND CASH EQUIVALENTS		
Beginning of year	14,933	16,516
End of year	$ 4,073	$ 14,933

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Cash payments for interest	$ 2,487	$ 2,545

See accompanying notes.

Note 1 – Nature of the Institute

The Salk Institute for Biological Studies, San Diego, California (the “Institute”) conducts basic biomedical research funded primarily with grants and contributions from agencies of the United States government, foundations, and the general public.

The Institute is a California not-for-profit public benefit corporation exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code and Section 23701(d) of the California Revenue and Taxation Code. Income determined to be unrelated business income is taxable, when present.

Note 2 – Significant Accounting Policies

General – The financial statements have been prepared on the accrual basis of accounting and in accordance with accounting principles generally accepted in the United States of America (“GAAP”). Net assets and activities are presented as unrestricted, temporarily restricted, and permanently restricted based on related donor restrictions or lack of such restrictions. Unrestricted net assets represent expendable funds available for operations, which are not otherwise limited by donor restrictions. Temporarily restricted net assets consist of contributed funds whose use is limited by donor-imposed restrictions that either expire by passage of time or can be fulfilled and removed by actions of the Institute pursuant to the stipulations. Permanently restricted net assets are subject to irrevocable donor restrictions requiring the assets be maintained in perpetuity, usually for the purpose of generating investment income to fund research and other activities.

The costs of providing program services and other activities are summarized on a functional expense basis in the statements of activities and, accordingly, certain costs have been allocated among the activities benefited.

Revenue Recognition

Grants – Grant revenue is recognized as unrestricted revenue when the related research costs are incurred, up to the maximum grant amount. Unspent grant funds received in advance of the related expenditures are reported as unexpended advances. Reimbursement for indirect expenses on certain research grants is based on specified rates applied to allowable direct expenses.

Contributions – Contributions are recorded as revenue at fair value when unconditionally pledged or when received, whichever is earlier. Contributions subject to donor-imposed restrictions for use in a future period or for a specific purpose are reported as either temporarily or permanently restricted, depending on the nature of the donor’s restriction. When a donor restriction expires or is fulfilled, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statements of activities as net assets released from restrictions.

Note 2 – Significant Accounting Policies (continued)

Contributions (continued) – Contributions of equipment or other long-lived assets are recognized when pledged or received, whichever is earlier, and recorded at the fair value of the contributed asset at the time of donation. If donors stipulate how long the assets must be used, the contributions are recorded as restricted support. In the absence of such stipulations, contributions of property and equipment are recorded as unrestricted support.

Cash and Cash Equivalents – Cash and cash equivalents are defined as cash on hand and in banks, plus highly liquid investments, which fund the daily operating activities of the Institute and have a maturity, at the date of purchase, of three months or less. Cash and cash equivalents held within the investment portfolio as part of the Institute's investment strategy are included in investments on the statements of financial position.

Receivables and Other Assets – Receivables and other assets include amounts billed and unbilled on grants and other agreements through June 30. An allowance for estimated uncollectible accounts is recorded based on past experience and an analysis of current receivable balances. Accounts are written off against the allowance when deemed uncollectible. Management has determined that an allowance of $85 and $29 is necessary at June 30, 2015 and 2014, respectively.

Also included in receivables and other assets is the Institute's beneficial interest in split-interest agreements which provide for the payment of distributions to the donor or other designated beneficiaries over the split-interest agreement's term (usually the beneficiary's lifetime). At the end of a split-interest agreement's term, the remaining assets are available for use by the Institute for the purpose specified by the donor. The portion of the assets attributable to the fair value of the future benefits to be received by the Institute is recorded on the statement of activities as temporarily or permanently restricted contribution revenue in the year the split-interest agreement is established. The fair value of the Institute's beneficial interest in split-interest agreements totaled $2,410 and $1,756 at June 30, 2015 and 2014, respectively.

Contributions Receivable – Contributions receivable consists of unconditional promises to give. Unconditional promises to give that are expected to be collected in future years are recorded at fair value when the promise is made, based on a discounted cash flow model. The discounts on these amounts are computed using risk-free rates established at the time those promises are received. The discount rates for the contributions receivable range from 0.25 percent to 2.75 percent as of June 30, 2015. Amortization of the discounts is included in contributions. Conditional promises to give are not recorded as revenue until the conditions are substantially met. An allowance for estimated uncollectible contributions receivable is recorded based on management's judgment and analysis of the creditworthiness of the donors, past collection experience, and other relevant factors. Accounts are written off against the allowance when deemed uncollectible. Management has determined that no allowance for uncollectible contributions receivable is necessary as of June 30, 2015 and 2014.

Note 2 – Significant Accounting Policies (continued)

Investments – Investments in marketable securities are carried at their fair values based on quoted prices in an active market. Alternative investments for which quoted market prices are not available are valued at fair value by third-party fund managers or the general partners of the related investment partnerships, based on factors deemed relevant by the general partners including, but not limited to, market conditions, purchase price, estimated liquidation value, restrictions on transfer, and meaningful third-party transactions in the private market. The Institute's Finance Department, under the supervision of the Chief Financial Officer, determines the investment fair value measurement policies and procedures in consultation with the Institute's investment consultant. These policies and procedures are reassessed at least annually to determine if the current valuation techniques are still appropriate. At that time, the unobservable inputs used in the fair value measurements are evaluated and adjusted, as necessary, based on current market conditions and other third-party information. The Institute reviews and evaluates the values provided by third-party fund managers and general partners and agrees with the valuation methods and assumptions used in determining the fair value of alternative investments. For these investments, the Institute uses the net asset value ("NAV") provided by the investment fund managers to evaluate the fair value of the investments (see Notes 4 and 9). The NAV may be adjusted based on liquidity factors or other information about the investments that management considers significant to the valuation of the investments.

Realized and unrealized gains and losses are included in investment return in the change in net assets on the accompanying statements of activities.

Funds Held by Trustees – At June 30, 2015, funds held by trustees include $17,087 required to be held in a separate account under the Certificates of Participation agreement and revenue bonds (Note 6) and are comprised of cash and cash equivalents. In addition, funds held by trustees include $9,672 held in mutual funds in a rabbi trust to pay the benefits provided by the Institute's retiree health plan (Note 8). Funds held by trustees held in mutual funds are carried at their fair value based on quoted prices in an active market.

Property – Property, including land, buildings, and equipment, is carried at cost. The Institute capitalizes acquisitions of property of $5 or more. Depreciation and amortization are recorded using the straight-line method over estimated useful lives of the assets ranging from 3 to 50 years.

Impairment of Long-lived Assets – The Institute evaluates long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. If the estimated future cash flows (undiscounted and without interest charges) from the use of an asset are less than the carrying value, a write-down will be recorded to reduce the related asset to its estimated fair value. To date, no such write-downs have occurred.

Note 2 – Significant Accounting Policies (continued)

Endowments – The Institute's endowment consists of approximately 100 individual funds established for a variety of purposes. The endowment includes both donor-restricted endowment funds and funds designated by the Board of Trustees (the "Board") to function as endowments. Net assets associated with endowment funds, including funds designated by the Board to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

The Institute classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Institute in a manner consistent with the standard of prudence prescribed by California's enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 ("UPMIFA"). In accordance with UPMIFA, the Institute considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

1) The duration and preservation of the fund;
2) The purposes of the Institute and the donor-restricted endowment fund;
3) General economic conditions;
4) The possible effect of inflation and deflation;
5) The expected total return from income and the appreciation of investments;
6) Other resources of the Institute; and
7) The investment policies of the Institute.

The Institute has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs and activities supported by its endowment while seeking to maintain the purchasing power of the endowment assets. The Institute's spending and investment policies work together to achieve this objective. The investment policy establishes an achievable return objective through diversification of asset classes. The current long-term return objective is a total return, over rolling ten-year periods, which exceeds inflation by an average of 5 percent per year. Actual returns in any given year may vary from this amount.

To satisfy its long-term rate-of-return objectives, the Institute relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Institute targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

Note 2 – Significant Accounting Policies (continued)

The Institute has a policy of appropriating for distribution each year a percentage of its endowment funds' average fair value over the prior 12 quarters. The percentage distribution is determined annually by the Board in the budget approval process and was 5 percent for each of the years ended June 30, 2015 and 2014. In establishing this policy, the Institute considered the long-term expected return on its endowment. Accordingly, over the long term, the Institute expects the current spending policy to allow its endowment to grow at an average of the biomedical inflation rate annually. This is consistent with the Institute's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term with the goal of meeting current and future cash flow requirements, as well as to provide additional real growth through new gifts.

Use of Estimates – The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, 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.

Risks and Uncertainties – The Institute invests in various types of securities which are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near-term and such changes could materially affect the amounts reported in the statement of financial position.

In recent years, there has been significant volatility in the domestic and international investment markets. Consequently, the fair value of the Institute's investments is exposed to higher than typical price volatility which could result in a substantial reduction in the fair value of certain investments from the amounts reported as of June 30, 2015.

Reclassifications – Certain reclassifications have been made to the 2014 amounts in order to conform to the presentation for the year ended June 30, 2015, with no impact to net assets.

Subsequent Events – Subsequent events are events or transactions that occur after the statement of financial position date but before the financial statements are issued. The Institute recognizes in the financial statements the effects of all significant subsequent events that provide additional evidence about conditions that existed at the date of the statement of financial position, including the estimates inherent in the process of preparing the financial statements. The Institute's financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the statement of financial position but arose after the statement of financial position date and before the financial statements are available to be issued. The Institute has evaluated subsequent events through September 30, 2015, which is the date the financial statements were available to be issued.

(IN THOUSANDS)

Note 2 – Significant Accounting Policies (continued)

Recent Accounting Pronouncement – In May 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2015-07, *Fair Value Measurement* (Topic 820): *Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share* (or Its Equivalent). The amendment removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. The amendment also removes the requirement to make certain disclosures for all investments that are eligible to be measured at fair value using the net asset value per share practical expedient. Rather, those disclosures are limited to investments for which the entity has elected to measure the fair value using that practical expedient. The amendments are effective for fiscal years beginning after December 15, 2016, and should be applied retrospectively to all periods presented. Earlier application is permitted. This ASU will have an impact on the disclosures to financial statements of the Institute.

Note 3 – Contributions Receivable

Contributions receivable are summarized as follows at June 30:

	2015	2014
Contributions receivable to be paid in:		
Less than one year	$ 8,410	$ 9,986
One to five years	13,210	15,285
More than five years	20,400	20,300
	42,020	45,571
Less unamortized discount	(4,785)	(4,841)
Total contributions receivable, net	$ 37,235	$ 40,730

At June 30, 2015 and 2014, net contributions receivable of $10,110 and $13,786, respectively, are from members of the Board.

Note 4 – Investments

The Institute's portfolio is managed by independent professional investment managers subject to direction and oversight by a committee of the Board. Certain of these managers are authorized to invest a limited portion of the Institute's portfolio in alternative investments to increase portfolio diversification and return and reduce volatility.

(IN THOUSANDS)

Note 4 – Investments (continued)

Investments are summarized as follows at June 30:

	2015	2014
Marketable securities:		
Cash and cash equivalents	$ 6,634	$ 23,100
Equity securities	52,632	46,791
Mutual funds:		
Global equity	82,674	78,105
Large cap equity	40,523	38,484
Emerging markets	13,165	12,880
Total marketable securities	195,628	199,360
Alternative investments:		
Distressed securities funds	43,106	43,179
Fixed income funds	42,001	37,328
Global equity funds	43,419	36,719
Private equity funds	2,630	2,466
Long/short equity funds	164	195
Total alternative investments	131,320	119,887
Total investments	$ 326,948	$ 319,247

Alternative investments are generally less liquid than the Institute's other investments. The nature and risks of these investments as of June 30, 2015, are summarized as follows:

	Fair Value	Unfunded Commitments	Redemption Frequency (if eligible)	Redemption Notice Period
Distressed securities funds:				
Active	$ 35,763	$ -	bi-annually, annually	60-180 days
Non-redeemable	7,168	960	n/a	n/a
Liquidating	175	-	n/a	n/a
Global equity funds	43,419	-	bi-monthly, monthly	1-15 days
Long/short equity funds:				
Liquidating	164	-	n/a	n/a
Fixed income funds	42,001	-	daily, monthly	5-15 days
Private equity funds	2,630	10,385	n/a	n/a
	$ 131,320	$ 11,345		

Note 4 – Investments (continued)

The distressed securities funds primarily invest in distressed debt and mortgage investments, undervalued securities, private investments, debt and equity securities of companies involved in or affected by the real estate and mortgage crisis, and fixed income securities, including commercial bank loan debt. The fair values of the investments in this category have been estimated using the NAV of the Institute's ownership interest in the funds or the Institute's share of partners' capital. This category includes investments of $4,612 which are not eligible for redemption until February 1, 2020. The investment manager for investments of $10,504 in this category may suspend redemption rights for up to one year if disposal of the fund's assets would not be reasonably practicable, would be prejudicial to non-redeeming members, or would have an adverse effect on the fund; in addition, full redemption of the investment may occur over a three-year period. This category includes investments of $1,932 for which there may be limitations on withdrawals due to the illiquidity of underlying investments, and the general partner may suspend redemption rights if it determines that the disposal of the fund's assets would not be reasonably practicable and might seriously prejudice the limited partners of the fund, or for up to three months at its sole discretion. Investments of $17,400 include gate provisions that do not exceed one year after the initial redemption period. An investment of $7,168 in distressed securities funds can never be redeemed with the fund as the nature of this investment is that distributions are received through the liquidation of the underlying assets of the fund after the investment period ends.

Global equity funds are invested in shares of companies listed on stock exchanges around the world. The value of $13,534 of the investments in this category has been estimated based on the Institute's share of partners' capital, and the investment manager may suspend redemption rights if it deems such suspension to be in the best interest of the fund. The fair value of the remaining investments in this category has been estimated using the NAV of the Institute's ownership interest in the fund.

The fixed income funds invest primarily in investment-grade debt and fixed income securities, fixed- and floating-rate debt securities, and debt obligations of governments or government-related issuers worldwide. The fair values of the investments in this category have been estimated using the NAV of the Institute's ownership interest in the funds. Investments of $16,143 are in a fund whose board may suspend redemption rights if it deems such suspension is in the best interests of the fund, and 10 percent of redemptions may be retained by the fund until the next annual audit is completed.

The private equity funds are invested primarily in pooled investment vehicles purchased from existing owners and not from the issuers of such investments and in the communications, media, and technology sector. The fair value of the investments in this category has been estimated using the NAV of the Institute's ownership interest in the funds. The investments in this category can never be redeemed with the funds as the nature of these investments is that distributions are received through the liquidation of the underlying assets of the funds. The investment periods for investments of $1,842 and $438 ended in June 2012 and April 2015, respectively, and an investment of $350 has an investment period that ends in December 2015.

(IN THOUSANDS)

Note 4 – Investments (continued)

Investments include endowment funds and general funds of the Institute. The Board has designated a portion of the Institute's cumulative investment return on general funds to be used for support of current operations. Under the Institute's spending policy, the Board determines annually a percentage of the average of the fair value of the Institute's general fund investment balances for the previous three years for appropriation to support current operations. The spending rate was 5 percent in 2015 and 2014.

The composition of investment return includes the following for the years ended June 30, 2015 and 2014:

	2015			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Interest and dividends	$ 1,095	$ 1,780	$ -	$ 2,875
Net gain (loss)	69	(237)	-	(168)
Investment return	1,164	1,543	-	2,707
Investment return designated for current operations	4,996	7,102	-	12,098
Investment return in excess of amounts designated for current operations	$ (3,832)	$ (5,559)	$ -	$ (9,391)

	2014			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Interest and dividends	$ 1,291	$ 1,502	$ -	$ 2,793
Net gain	19,366	25,792	-	45,158
Investment return	20,657	27,294	-	47,951
Investment return designated for current operations	4,426	6,214	-	10,640
Investment return in excess of amounts designated for current operations	$ 16,231	$ 21,080	$ -	$ 37,311

(IN THOUSANDS)

Note 5 – Property

Property is summarized as follows at June 30:

	2015	2014
Land	$ 1,154	$ 1,154
Buildings and improvements	145,912	144,098
Laboratory equipment	60,989	61,780
Other equipment	12,859	12,689
Construction in progress	1,620	229
	222,534	219,950
Less accumulated depreciation and amortization	(147,301)	(142,543)
Total property, net	$ 75,233	$ 77,407

Included in total expenses is depreciation expense of $11,815 and $12,001 for the years ended June 30, 2015 and 2014, respectively.

Note 6 – Debt

In July 2005, the Institute issued revenue bonds through the California Statewide Communities Development Authority totaling $25,135 to prepay, together with other available moneys, $26,940 of the aggregate principal amount of the outstanding Certificates of Participation issued in 1994 to fund the construction of the research buildings expansion project. The 2005 bonds consist of $25,135 in serial bonds due from July 1, 2007 through July 1, 2024, at interest rates ranging from 3.00 percent to 5.25 percent. At June 30, 2015, a premium of $319 on the bonds is being amortized over the life of the bonds.

In May 2010, the Institute issued Certificates of Participation (the "2010 Certificates") through the County of San Diego totaling $37,445 to fund the construction and renovation of the Institute's facilities, including the renewal and expansion of the central plant and electrical distribution infrastructure, and to prepay, together with other available moneys, $12,920 of the aggregate principal amount of the outstanding Certificates of Participation issued in 2000 to fund the construction of a new research building. The 2010 Certificates consist of $8,595 in serial certificates due from July 1, 2011 through July 1, 2025, at interest rates ranging from 3.00 percent to 5.00 percent; $7,320 in 5.25 percent term certificates due on July 1, 2030; and $21,530 in 5.125 percent term certificates due on July 1, 2040. At June 30, 2015, a discount of $205 is being amortized over the life of the 2010 Certificates.

(IN THOUSANDS)

Note 6 – Debt (continued)

In August 2014, the Institute and a bank completed a tax-exempt loan of $31,190 through the California Statewide Communities Development Authority ("2014 Loan") to be used for the payment of debt service and redemption on July 2, 2015, of the $15,375 outstanding aggregate principal amount of the 2005 bonds (Note 13) and for the renovation, restoration, improvement, and equipping of buildings, laboratories, offices, and other related facilities on the Institute's campus. The 2014 Loan provides for monthly draws as funds are required for the loan purposes and for level debt service in conjunction with the 2010 Certificates, with final maturity on July 1, 2044, and a fixed interest rate of 3.40 percent. As of June 30, 2015, the Institute had drawn $1,635 of the available loan funds.

In May 2015, the Institute placed $14,115 in a prepayment account with the trustee of the 2005 bonds in order to redeem the outstanding 2005 bonds on July 2, 2015 (Note 13). In addition to its operating cash and cash from the investment pool, the Institute borrowed $3,000 on its line of credit (Note 10) to fund the prepayment account. The outstanding balance on the line of credit at June 30, 2015 is included in accounts payable and accrued expenses.

Issuance costs related to the 2010 Certificates, 2005 bonds, and 2014 Loan are being amortized over the lives of the respective debt instruments. Amortization expense related to the issuance costs was $68 and $54 for the years ended June 30, 2015 and 2014, respectively.

After full funding of the 2014 Loan, including the refinancing of the 2005 bonds on July 2, 2015 (see Note 13), the future annual principal payments under the 2010 Certificates and the 2014 Loan will be as follows:

Years ending June 30,		
2016	$	1,330
2017		1,257
2018		1,299
2019		1,347
2020		1,395
Thereafter		59,846
		66,474
Net unamortized premium and discount		92
Net unamortized costs of issuance		(1,210)
	$	65,356

The Institute's debt is collateralized by all of the revenue of the Institute and further secured by a deed of trust on the Institute's main campus. The fair value of the debt as of June 30, 2015 and 2014 is approximately $55,143 and $55,704, respectively, based on current interest rates for obligations with similar terms. The Institute determined the debt to be a Level 2 measurement in the fair value hierarchy described in Note 9.

(IN THOUSANDS)

Note 6 – Debt (continued)

Interest expense related to the Institute's debt was $2,456 and $2,523 for the years ended June 30, 2015 and 2014, respectively.

Under the terms of the Institute's debt, the Institute is subject to compliance with certain covenants, including restrictions on additional indebtedness.

Note 7 – Net Assets

Net assets at June 30 are summarized as follows:

	2015	2014
Unrestricted	$ 100,070	$ 106,869
Temporarily Restricted		
Research	98,315	97,895
Appreciation on unrestricted use endowments	6,124	6,847
Total temporarily restricted	104,439	104,742
Permanently Restricted		
Research	122,580	118,948
Unrestricted use	49,930	48,398
Total permanently restricted	172,510	167,346
Total net assets	$ 377,019	$ 378,957

Net assets were released from restrictions by satisfying donor restrictions for the following purposes during the years ended June 30:

	2015	2014
Temporarily Restricted		
Research	$ 19,864	$ 15,286
Unrestricted use	1,330	1,170
Total releases from restriction	$ 21,194	$ 16,456

(IN THOUSANDS)

Note 7 – Net Assets (continued)

The net asset composition of the Institute's donor-restricted and board-designated endowments is as follows at June 30:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment Net Assets:				
2015				
Donor-restricted	$ -	$ 42,737	$ 172,510	$ 215,247
Board-designated	3,452	-	-	3,452
Total	$ 3,452	$ 42,737	$ 172,510	$ 218,699
2014				
Donor-restricted	$ -	$ 47,930	$ 167,346	$ 215,276
Board-designated	3,354	-	-	3,354
Total	$ 3,354	$ 47,930	$ 167,346	$ 218,630

The changes in endowment net assets for the years ended June 30, 2015 and 2014 are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets at July 1, 2013	$ 1,589	$ 26,940	$ 139,109	$ 167,638
Investment return:				
Interest and dividends	25	1,502	-	1,527
Net gains	408	25,702	-	26,110
Total investment return	433	27,204	-	27,637
Contributions	1,404	-	28,237	29,641
Amounts appropriated for expenditure	(72)	(6,214)	-	(6,286)
Endowment net assets at June 30, 2014	3,354	47,930	167,346	218,630
Investment return:				
Interest and dividends	31	1,731	-	1,762
Net (losses) gains	(48)	178	-	130
Total investment return	(17)	1,909	-	1,892
Contributions	200	-	5,164	5,364
Amounts appropriated for expenditure	(85)	(7,102)	-	(7,187)
Endowment net assets at June 30, 2015	$ 3,452	$ 42,737	$ 172,510	$ 218,699

(IN THOUSANDS)

Note 7 – Net Assets (continued)

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or UPMIFA requires the Institute to retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature are reported in unrestricted net assets. There were no deficiencies as of June 30, 2015 or 2014.

Note 8 – Employee Benefit Plans

Retirement Plans – The Institute has an Employee Retirement Plan for certain of its employees. The plan is a defined-contribution plan under which the Institute contributes a percentage of the participant's annual compensation. The Institute's contributions are made in accordance with Section 403(b) of the Internal Revenue Code. Total contributions expense related to the plan was $3,483 for each of the years ended June 30, 2015 and 2014.

Retiree Health Benefits Plan – The Institute sponsors a defined-benefit plan (the "Plan") that provides for retirees' health and related benefits. Employees hired prior to June 30, 1993, may become eligible for these post-retirement benefits upon attainment of age 60 with 10 years of service. The Plan includes cost-sharing features such as deductibles, coinsurance, and contributions, which can be adjusted annually, and the Institute's policy is to pay these benefits through a rabbi trust. The Institute uses a June 30 measurement date for the Plan.

The changes in the accumulated post-retirement benefit obligation at June 30, 2015 and 2014 for the Plan are as follows:

	2015	2014
Benefit obligation, beginning of year	$ 5,899	$ 5,833
Service cost	37	41
Interest cost	251	238
Actuarial (gain) loss	620	(8)
Benefits paid	(213)	(205)
Benefit obligation, end of year	$ 6,594	$ 5,899
Funded status of Plan, end of year	$ (6,594)	$ (5,899)
Rabbi trust investments, end of year	$ 9,672	$ 9,344

(IN THOUSANDS)

Note 8 – Employee Benefit Plans (continued)

At June 30, 2015 and 2014, the components of the net periodic post-retirement benefit cost are:

	2015	2014
Service cost	$ 37	$ 41
Interest cost	251	238
Amortization of transition obligation	117	114
Amortization of net gain	(20)	(99)
Net periodic post-retirement benefit cost	$ 385	$ 294

The deferred transition obligation and deferred actuarial gains and losses are not reflected in net periodic post-retirement benefit cost and are included in unrestricted net assets at June 30. The changes in the deferred amounts are as follows:

	2015		2014	
	Deferred Gain	Transition Obligation	Deferred Gain	Transition Obligation
Balance, beginning of year	$ 1,563	$ (117)	$ 1,654	$ (231)
Actuarial gain (loss)	(620)	-	8	-
Amortization:				
Deferred transition obligation	-	117	-	114
Deferred actuarial loss	(20)	-	(99)	-
Balance, end of year	$ 923	$ -	$ 1,563	$ (117)

The amounts of the transition obligation and the net actuarial gain included in unrestricted net assets at June 30, 2015, that are expected to be recognized in net periodic post-retirement benefit cost during the fiscal year ended June 30, 2016, are ($117) and $17, respectively.

The benefits expected to be paid from the Plan in each of the next five years and in the aggregate for the following five years are as follows:

Years ending June 30,	
2016	$ 418
2017	410
2018	416
2019	417
2020	412
2021-2025	2,008
	$ 4,081

(IN THOUSANDS)

Note 8 – Employee Benefit Plans (continued)

Contributions to the Plan are expected to equal benefit payments. For the years ended June 30, 2015 and 2014, employer contributions were $213 and $205, respectively, and participant contributions were $135 and $116, respectively.

The Plan's weighted-average assumptions used to determine net periodic post-retirement benefit cost for the years ended June 30 were as follows:

	2015	2014
Discount rate	3.95%	4.47%
Rate of compensation increase	5.00%	5.00%

The amounts reported are affected by the healthcare trend assumptions. The assumed healthcare cost trend rate used in measuring the accumulated benefit obligation was 6.25 percent and 7.00 percent for 2015 and 2014, respectively, and is assumed to decrease gradually to 4.50 percent in 2077 and remain at that level thereafter. If the healthcare cost trend assumptions were increased by 1 percent, the accumulated post-retirement benefit obligation at June 30, 2015 and 2014, would be increased by approximately $66 and $63, respectively. The effect of this change would increase the aggregate of the service and interest cost components of the net periodic post-retirement benefit cost by approximately $2 and $3 for the years ended June 30, 2015 and 2014, respectively. If the healthcare cost trend assumptions were decreased by 1 percent, the accumulated post-retirement benefit obligation as of June 30, 2015 and 2014, would be decreased by approximately $61 and $58, respectively. The effect of this change would reduce the aggregate of the service and interest cost components of the net periodic post-retirement benefit cost by approximately $2 and $3 for the years ended June 30, 2015 and 2014, respectively.

Note 9 – Fair Value of Financial Instruments

Authoritative guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date and establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance describes three levels of inputs that may be used to measure fair value:

Level 1 - Quoted prices in active markets for identical assets or liabilities;

Level 2 - Inputs, other than quoted prices, that are observable for the asset or liability, directly or indirectly, including inputs in markets that are not considered to be active; and

Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Transfers between levels are recognized as of the beginning of the reporting period in which the transfer occurs.

(IN THOUSANDS)

Note 9 – Fair Value of Financial Instruments (continued)

The carrying values of cash and cash equivalents, receivables, and accounts payable approximate their fair values due to the relatively short period of time between origination of the instruments and their expected realization. These assets and liabilities are considered by the Institute to be Level 1 measurements in the fair value hierarchy.

The following table presents information about each major category of the Institute's financial assets measured at fair value on a recurring basis at June 30, 2015:

	Fair Value Measurement at June 30, 2015			
	Level 1	Level 2	Level 3	Total
Marketable securities:				
Cash and equivalents	$ 23,848	$ -	$ -	$ 23,848
Equity securities:				
Consumer products	11,633	-	-	11,633
Energy and utilities	8,896	-	-	8,896
Healthcare	8,869	-	-	8,869
Industrial	7,003	-	-	7,003
Information technology	6,028	-	-	6,028
Financial	5,244	-	-	5,244
Materials	1,861	-	-	1,861
Telecommunications	1,581	-	-	1,581
Other	1,517	-	-	1,517
Total equity securities	52,632	-	-	52,632
Mutual funds:				
Global equity	84,455	-	-	84,455
Large cap equity	46,028	-	-	46,028
Emerging markets	13,166	-	-	13,166
Fixed income	2,258	-	-	2,258
Total mutual funds	145,907	-	-	145,907
Total marketable securities	222,387	-	-	222,387
Alternative investments:				
Global equity funds	-	29,885	13,534	43,419
Distressed securities funds	-	1,315	41,791	43,106
Fixed income funds	-	25,858	16,143	42,001
Private equity funds	-	-	2,630	2,630
Long/short equity funds	-	-	164	164
Total alternative investments	-	57,058	74,262	131,320
Beneficial interest in split-interest agreements	-	-	2,410	2,410
	$ 222,387	$ 57,058	$ 76,672	$ 356,117

(IN THOUSANDS)

Note 9 – Fair Value of Financial Instruments (continued)

The following table presents information about each major category of the Institute's financial assets measured at fair value on a recurring basis at June 30, 2014:

	Fair Value Measurement at June 30, 2014			
	Level 1	Level 2	Level 3	Total
Marketable securities:				
Cash and equivalents	$ 26,180	$ -	$ -	$ 26,180
Equity securities:				
Energy and utilities	8,591	-	-	8,591
Industrial	7,847	-	-	7,847
Consumer products	6,986	-	-	6,986
Healthcare	6,556	-	-	6,556
Information technology	6,219	-	-	6,219
Financial	4,816	-	-	4,816
Materials	3,112	-	-	3,112
Telecommunications	1,290	-	-	1,290
Other	1,374	-	-	1,374
Total equity securities	46,791	-	-	46,791
Mutual funds:				
Global equity	79,965	-	-	79,965
Large cap equity	43,610	-	-	43,610
Emerging markets	12,880	-	-	12,880
Fixed income	2,220	-	-	2,220
Total mutual funds	138,675	-	-	138,675
Total marketable securities	211,646	-	-	211,646
Alternative investments:				
Distressed securities funds	-	1,256	41,923	43,179
Fixed income funds	-	20,915	16,413	37,328
Global equity funds	-	21,529	15,190	36,719
Private equity funds	-	-	2,466	2,466
Long/short equity funds	-	-	195	195
Total alternative investments	-	43,700	76,187	119,887
Beneficial interest in split-interest agreements	-	-	1,756	1,756
	$ 211,646	$ 43,700	$ 77,943	$ 333,289

(IN THOUSANDS)

Note 9 – Fair Value of Financial Instruments (continued)

The following table presents the summary of changes in the fair value of the Institute's Level 3 classified assets for 2015 and 2014:

	Alternative Investments						
	Distressed Securities Funds	Global Equity Funds	Long/Short Equity Funds	Fixed Income Funds	Private Equity	Beneficial Interest in Split-Interest Agreements	Total
Balance, July 1, 2013	$ 32,410	$ 14,074	$ 239	$ 12,095	$ 2,668	$ 1,837	$ 63,323
Realized and unrealized gains	4,287	1,256	-	818	329	-	6,690
Change in value of beneficial interest	-	-	-	-	-	(81)	(81)
Purchases	8,039	-	-	3,500	-	-	11,539
Sales	(2,813)	(140)	(44)	-	(531)	-	(3,528)
Balance, June 30, 2014	41,923	15,190	195	16,413	2,466	1,756	77,943
Transfers out of Level 3	(1,923)						(1,923)
Realized and unrealized gains (losses)	1,147	(1,513)	(3)	(270)	154	-	(485)
Change in value of beneficial interest	-	-	-	-	-	654	654
Purchases	3,994	-	-	-	788	-	4,782
Sales	(3,350)	(143)	(28)	-	(778)	-	(4,299)
Balance, June 30, 2015	$ 41,791	$ 13,534	$ 164	$ 16,143	$ 2,630	$ 2,410	$ 76,672

Alternative investments transferred out of Level 3 assets in 2015 are investments for which the redemption restriction periods lapsed and which became redeemable at NAV.

Realized and unrealized (losses) gains of ($485) and $6,690 are reported on the statements of activities as a component of investment return in excess of amount designated for current operations for the years ended June 30, 2015 and 2014, respectively. The change in the value of the beneficial interest in split-interest agreements is included in contributions on the statements of activities. Of the total fiscal years' 2015 and 2014 net gains (losses) that are included in investment return in excess of amount designated for current operations, $1,611 and $6,454 are due to net unrealized gains from Level 3 assets still held at June 30, 2015 and 2014, respectively.

(IN THOUSANDS)

Note 9 – Fair Value of Financial Instruments (continued)

The following table presents information about significant unobservable inputs for Level 3 assets and liabilities, excluding investments valued at NAV or partnership percentage, as discussed in Note 4:

Asset/Liability	Fair Value as of June 30, 2015	Valuation Technique	Unobservable Input(s)	Range (Wtd. Avg.)
Beneficial interest in split-interest agreements	$ 2,410	Discounted cash flow	Discount rate Mortality tables	2.0% (2.0%)

Increases (decreases) in the discount rate or life expectancy based on mortality tables would result in decreases (increases) in the fair value of the beneficial interest in split-interest agreements. An increase (decrease) in the fair value of the assets in the related trust or the increase in the Institute's percentage ownership will increase (reduce) the fair value of the Institute's beneficial interest in the split-interest agreement.

In determining the reasonableness of the methodology used to determine the fair value of the beneficial interest in split-interest agreements, the Finance Department evaluates a variety of factors including a review of existing agreements, economic conditions, and industry and market developments at least annually. Certain unobservable inputs are assessed through review of contract terms (e.g., duration or payout data), while others are substantiated utilizing available market data (e.g., discount rates and mortality tables).

Note 10 – Commitments and Contingencies

Commitments – At June 30, 2015, contractual commitments on construction and purchases pending or in process are $4,716.

Leases – The Institute has entered into operating leases for building space and equipment that expire through December 2021. Rent expense totaled $914 and $897 for the years ended June 30, 2015 and 2014, respectively. Future minimum rental payments required under non-cancelable operating leases that have remaining lease terms in excess of one year as of June 30, 2015, are as follows:

Years ending June 30,	
2016	$ 806
2017	761
2018	779
2019	749
2020	767
Thereafter	527
	$ 4,389

Note 10 – Commitments and Contingencies (continued)

Line of Credit – In September 2014, the Institute executed an unsecured line of credit loan agreement with a bank providing up to $5,000 for general working capital purposes. The agreement expires on September 10, 2015, and provides for monthly interest at the prime rate (3.25 percent on June 30, 2015) on the outstanding balance. At June 30, 2015, $3,000 was outstanding on the line of credit.

Grants – The Institute has grants with various organizations and government agencies which are subject to audit. Management believes that any liability which may result from these audits would not be material.

Income Taxes – The Institute has no unrecognized tax benefits as of June 30, 2015 and 2014.

The Institute files an exempt organization tax return in the United States federal jurisdiction and a copy with the state charities division. With few exceptions, the Institute is no longer subject to United States federal or state/local income tax examinations by tax authorities for years before 2012.

Legal – The Institute is a party to certain legal actions arising in the ordinary course of business. In the opinion of management, additional liabilities, if any, under these actions will not result in material charges against net assets.

Guarantees and Indemnities – From time to time, the Institute enters into certain types of contracts that contingently require the Institute to indemnify parties against third-party claims. These contracts primarily relate to: (i) certain technology transfer/license agreements under which the Institute may be required to indemnify licensees; and (ii) certain agreements with the Institute's officers, directors, and employees, under which the Institute may be required to indemnify such persons for liabilities arising out of their employment relationship. The terms of such obligations vary by contract and, in most instances, a specific or maximum dollar amount is not explicitly stated therein. Generally, amounts under those contracts cannot be reasonably estimated until a specific claim is asserted. Consequently, no liabilities have been recorded for these obligations in the Institute's statements of financial position for the years ended June 30, 2015 and 2014.

Note 11 – Concentrations of Credit Risk

Cash in bank deposit accounts and the investment portfolio exceeds federally-insured deposit limits. No losses have been experienced related to cash in such accounts.

The Institute receives funds under various research grants from federal and non-federal agencies. Funding from the National Institutes of Health represents approximately 53 percent and 58 percent of total grant revenue for the years ended June 30, 2015 and 2014, respectively.

Note 12 – Related Party

In May 2006, the Institute and three other research institutions formed the San Diego Consortium for Regenerative Medicine, subsequently renamed Sanford Consortium for Regenerative Medicine ("SCRM") and joined by a fifth research institution. SCRM was formed to coordinate the institutions' resources, personnel, and programs for scientific research and education in the field of stem cell research and related fields. The nine-member board of SCRM includes a member of the Institute's Board and the Institute's President/Chief Executive Officer.

In October 2009, the consortium members and SCRM executed an agreement (the "Collaboratory Agreement") in which SCRM grants the members a non-exclusive license to use space for stem cell research in SCRM's research facility, which was ready for occupancy on January 1, 2012. The initial term of the Collaboratory Agreement is 10 years with options to extend. Under the agreement, the members agree to pay a license fee equal to each member's allocable share of licensed space debt service and operating expenses. The Institute's license fee and operating expenses for the use of three modules in SCRM's building are expected to be $231 and $355 per year, respectively, with increases or decreases to the amounts each year based on actual expenses. The fee to license space in the facility is included in rent expense and minimum lease payments in Note 10.

Note 13 – Subsequent Events

On July 2, 2015, the Institute drew $16,081 under the 2014 Loan (Note 6) to reimburse itself for the funds used to: (1) pay the January 1 and July 1, 2015, principal and interest payments on the 2005 bonds; and (2) fund the prepayment account for the redemption of the remaining outstanding 2005 bonds, in accordance with the 2014 Loan agreement. The line of credit balance was repaid with $3,000 of the funds drawn from the 2014 Loan.

Effective July 1, 2015, the Institute began to self-insure hospitalization and medical coverage under one of the health plans offered to its employees. The Institute limits its losses through the use of a stop-loss policy with a deductible of $150 per covered participant and a maximum liability of $2,828.