

**UNIVERSITY OF SOUTH FLORIDA
RESEARCH FOUNDATION, INC.
(A Component Unit of the
University of South Florida)**

FINANCIAL STATEMENTS AND
COMPLIANCE REPORT

As of and for the Year Ended June 30, 2018

And Reports of Independent Auditor

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.

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Report of Independent Auditor

To the Board of Directors of
University of South Florida
Research Foundation, Inc.
Tampa, Florida

Report on the Financial Statements

We have audited the accompanying financial statements of the University of South Florida Research Foundation, Inc. (the "Research Foundation"), a component unit of the University of South Florida, as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise the Research Foundation's basic financial statements, as listed in the table of contents.

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 audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 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 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 the Research Foundation, as of June 30, 2018, and the changes in its financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 8 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Research Foundation's basic financial statements. The schedule of functional expenses is presented for purposes of additional analysis and is not a required part of the basic financial statements. The schedule of functional expenses is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of functional expenses is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated October 2, 2018, on our consideration of the Research Foundation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Research Foundation's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Research Foundation's internal control over financial reporting and compliance.

A handwritten signature in black ink that reads "Cherry Bekant LLP". The signature is written in a cursive, flowing style.

Tampa, Florida
October 2, 2018

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

YEAR ENDED JUNE 30, 2018

Management's Discussion and Analysis

The management's discussion and analysis ("MD&A") provides an overview of the financial position and activities of the University of South Florida Research Foundation, Inc. (the "Research Foundation") for the fiscal year ended June 30, 2018, and should be read in conjunction with the financial statements and notes thereto. This overview is required by Governmental Accounting Standards Board ("GASB") Statement No. 35, *Basic Financial Statements and Management's Discussion and Analysis for Public Colleges and Universities*, as amended by GASB Statements Nos. 37 and 38. The MD&A, and financial statements and notes thereto, are the responsibility of the Research Foundation's management.

Financial Highlights

The Research Foundation's assets totaled \$91.0 million at June 30, 2018. This balance reflects an increase of \$3.6 million (4.1%) from total assets of \$87.4 million at June 30, 2017. Total liabilities decreased \$1.8 million (6.0%) to \$28.6 million at June 30, 2018 from \$30.4 million at June 30, 2017. The Research Foundation's net position increased by \$5.4 million (9.3%), reaching a year-end balance of \$62.6 million.

The Research Foundation's operating revenues were \$13.9 million in fiscal year 2018, for an increase of \$1.7 million (13.9%) from the prior fiscal year. Operating expenses in fiscal year 2018 were \$11.0 million for an increase of \$1.4 million (14.4%) from fiscal year 2017. Operating income for fiscal year 2018 was \$2.9 million, for an increase of \$303 thousand (11.8%) from the prior fiscal year.

Nonoperating revenue net of nonoperating expenses, was \$2.5 million in fiscal year 2018, for a 6.6% decrease from the \$2.6 million net nonoperating revenue in fiscal year 2017. Fiscal year 2018 increase in net position was \$5.4 million as a result of the excess of revenues over expenses.

Overview of Financial Statements

Pursuant to GASB Statement No. 35, the Research Foundation's financial report includes three basic financial statements: the statement of net position; the statement of revenues, expenses, and changes in net position; and the statement of cash flows.

The statement of net position reflects the assets, deferred outflows of resources, and liabilities of the Research Foundation, using the accrual basis of accounting, and presents the financial position of the Research Foundation at a specified time. The difference between total assets and deferred outflows of resources less total liabilities is net position. The net position is an indicator of the Research Foundation's financial health.

The statement of revenues, expenses, and changes in net position present the Research Foundation's revenue and expense activity, categorized as operating and nonoperating. Revenues and expenses are recognized when earned or incurred, regardless of when cash is received or paid.

The statement of cash flows provide information in the form of cash inflows and outflows summarized by operating, capital and related financing activities, and investing activities. This statement will assist in evaluating the Research Foundation's ability to generate net cash flows and its ability to meet its financial obligations as they come due.

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

YEAR ENDED JUNE 30, 2018

Condensed Statements of Net Position

The following summarizes the Research Foundation's assets, deferred outflows of resources, liabilities, and net position at June 30:

	<u>2018</u>	<u>2017</u>
ASSETS		
Current assets	\$ 41,251,212	\$ 35,429,080
Restricted cash	1,100,000	1,025,000
Capital assets, net	40,822,360	42,887,598
Other investments	322,037	235,606
Other noncurrent assets	<u>7,528,762</u>	<u>7,855,750</u>
Total Assets	<u>91,024,371</u>	<u>87,433,034</u>
DEFERRED OUTFLOWS OF RESOURCES		
Interest rate swap	<u>58,610</u>	<u>156,607</u>
LIABILITIES		
Current	11,315,382	11,334,107
Noncurrent	<u>17,213,610</u>	<u>19,031,607</u>
Total Liabilities	<u>28,528,992</u>	<u>30,365,714</u>
NET POSITION		
Net investment in capital assets	23,047,360	23,447,598
Unrestricted	<u>39,506,629</u>	<u>33,776,329</u>
Total Net Position	<u>\$ 62,553,989</u>	<u>\$ 57,223,927</u>

Current assets were \$41.3 million at June 30, 2018, for an increase of \$5.9 million (16.4%) from the prior fiscal year. The increase in current assets includes an increase in cash of \$1.1 million (28.1%), increase in investments of \$4.0 million (13.2%) and an increase of \$465 thousand (47.8%) in accounts receivable. Investment activity in fiscal year 2018 included additional investment of funds of \$1.0 million, investment gains of \$3.1 million, and the sale of investments as a source of funds for seed capital loan (\$50 thousand).

Capital assets decreased \$2.1 million (4.8%) to \$40.8 million at June 30, 2018 from \$42.9 million at June 30, 2017. The net decrease resulted from depreciation charges of \$2.8 million, offset by capital asset additions of \$726 thousand for fiscal year 2018.

Total liabilities decreased \$1.8 million (6.0%) to \$28.6 million at June 30, 2018 from \$30.4 million at June 30, 2017. Decrease in liabilities primarily resulted from scheduled principal payments of \$1.6 million made in fiscal year 2018. Also in fiscal year 2018, the fair value of the interest rate swap agreement decreased \$100 thousand (62.6%) as a result of debt payments.

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

YEAR ENDED JUNE 30, 2018

Condensed Statement of Revenues, Expenses, and Changes in Net Position

The following summarizes the Research Foundation's activities for the fiscal years ended June 30:

	<u>2018</u>	<u>2017</u>
Operating revenues	\$ 13,893,387	\$ 12,203,215
Operating expenses	11,020,571	9,633,109
Operating income	2,872,816	2,570,106
Net nonoperating revenues	2,457,246	2,631,784
Increase in net position	5,330,062	5,201,890
Net position, beginning of year	57,223,927	52,022,037
Net position, end of year	<u>\$ 62,553,989</u>	<u>\$ 57,223,927</u>

Operating Revenues

Operating revenues by source for the fiscal years ended June 30, 2018 and 2017 were as follows:

	<u>2018</u>	<u>2017</u>	<u>Increase (Decrease)</u>	<u>% Change</u>
Property rental revenues	\$ 7,441,994	\$ 7,151,463	\$ 290,531	4.1%
Royalties, licenses, and option fees	4,034,562	2,614,265	1,420,297	54.3%
Incubator sponsor revenue	1,269,950	1,248,250	21,700	1.7%
Incubator program revenue	604,561	516,038	88,523	17.2%
Contracts and grants	325,524	512,788	(187,264)	-36.5%
Administrative fees	216,796	160,411	56,385	35.2%
Total Operating Revenues	<u>\$ 13,893,387</u>	<u>\$ 12,203,215</u>	<u>\$ 1,690,172</u>	13.9%

Property rental revenues were \$7.4 million in fiscal year 2018 for an increase of \$291 thousand (4.1%). Revenue growth was generated from scheduled lease escalations, as well as increased occupancy.

Royalties, licenses and option fee revenue increased \$1.4 million (54.3%) in fiscal year 2018 primarily due to renegotiated agreements with a significant licensee and sublicensee. The termination of an existing license permitted the sublicensee to the agreement to assume all of the obligations, including payment directly to the Research Foundation, in lieu of to the original licensee. The agreement as restructured, together with increased royalty on sales, accounted for the growth in revenue.

The Research Foundation continues to pursue post-award management of private industry contracts and grants with the University of South Florida (the "University"). Operating revenue from contracts and grants which decreased \$187 thousand (36.5%) to \$326 thousand in fiscal year 2018, from \$513 thousand for the prior fiscal year, correlates to an operating expense entitled the same. Operating revenue and operating expense from contracts and grants represents only those agreements where the Research Foundation is the contracting party. Other contracts and grants in the amount of \$1.2 million, of which the University is the contracting party, have been eliminated and are reported by the University. When permitted by the agreement, an administrative fee is charged for processing expenditures, and is recognized as administrative fee revenue.

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

YEAR ENDED JUNE 30, 2018

Operating Expenses

The following summarizes the operating expenses for the fiscal years ended June 30, 2018 and 2017:

	<u>2018</u>	<u>2017</u>	<u>Increase (Decrease)</u>	<u>% Change</u>
Property rental expenses	\$ 5,606,590	\$ 5,249,805	\$ 356,785	6.8%
Incubator program expenses	1,089,385	1,125,892	(36,507)	-3.2%
Inventor royalties	985,916	852,503	133,413	15.6%
Inventing department and other royalties	566,689	577,338	(10,649)	-1.8%
Other Intellectual property costs	1,383,587	229,269	1,154,318	503.5%
Contracts and grants	325,524	512,788	(187,264)	-36.5%
University support	83,790	77,085	6,705	8.7%
Seed capital expense	25,000	75,000	(50,000)	-66.7%
Management and general	954,090	933,429	20,661	2.2%
Total Operating Expenses	<u>\$ 11,020,571</u>	<u>\$ 9,633,109</u>	<u>\$ 1,387,462</u>	14.4%

Research park operating expenses increased \$357 thousand in 2018 (6.8%) to \$5.6 million. The fiscal year 2018 increase is primarily attributed to increased costs for repairs and maintenance of \$199 thousand (18.4%) which includes additional parking lot repairs of \$89 thousand (295.7%). In addition, research park expenses for salary and fringe increase of \$115 thousand (27.0%) and depreciation cost increase of \$86 thousand (3.2%), were offset by reduced utilities cost of \$70 thousand (4.9%).

The increase in other intellectual property costs of \$1.2 million (503.5%) is associated with the growth in royalties, licenses and option fee revenue as previously discussed. The restructured license stipulated that the Research Foundation remit a portion of royalties received from the above mentioned sublicensee to the original licensee consistent with the executed agreement terms. The direct costs remitted to the original licensee is recorded as technology costs in the schedule of functional expenses.

Nonoperating Revenues and Expenses

Certain revenue sources including investment income are defined by GASB as nonoperating. Nonoperating expenses include capital financing costs and other costs related to capital assets. The following summarizes the Research Foundation's nonoperating revenues and expenses for the 2018 and 2017 fiscal years:

	<u>2018</u>	<u>2017</u>	<u>Change</u>	<u>% Change</u>
Nonoperating Revenues				
(Expenses):				
Investment income (loss)	\$ 3,117,270	\$ 3,464,517	\$ (347,247)	-10.0%
Interest income	26,865	25,067	1,798	7.2%
Interest expense	(686,889)	(827,720)	140,831	-17.0%
Other nonoperating loss	-	(30,080)	30,080	-100.0%
Total Net Nonoperating Revenues	<u>\$ 2,457,246</u>	<u>\$ 2,631,784</u>	<u>\$ (174,538)</u>	-6.6%

Nonoperating investment income of \$3.1 million in fiscal year 2018 includes realized gain for reinvested dividends and interest of \$1.6 million, and unrealized gains of \$1.5 million associated with increases in market values of investments.

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

YEAR ENDED JUNE 30, 2018

Condensed Statements of Cash Flows

The following summarizes cash flows for the 2018 and 2017 fiscal years:

	<u>2018</u>	<u>2017</u>
Cash flows from:		
Operating activities	\$ 5,083,065	\$ 5,905,383
Capital and related financing activities	(2,973,646)	(12,858,584)
Investing activities	(941,045)	7,422,432
Net increase in cash and cash equivalents	1,168,374	469,230
Cash and cash equivalents, beginning of year	4,909,116	4,439,886
Cash and cash equivalents, end of year	<u>\$ 6,077,490</u>	<u>\$ 4,909,116</u>

Fiscal year 2018 generated positive cash flow from operations of \$5.1 million. This represents a decrease of \$822 thousand (13.9%) from \$5.9 million generated in fiscal year 2017. Total disbursements in fiscal year 2018 increased \$1.7 million (25.3%) which exceeded the increase of \$841 thousand (6.7%) in total receipts.

Net cash flow from operating activities included increased cash flow from intellectual property of \$303 thousand and increase of \$33 thousand from contract and grants, offset by reduced cash flow from property rental activity of \$756 thousand, and reduced cash flow from management and general expenses of \$405 thousand.

Net cash used by capital and financing activities of \$3.0 million includes purchases and construction of capital assets of \$726 thousand, \$1.6 million payment of debt, payment of debt associated interest costs of \$641 thousand and seed capital loan activity.

Net cash used by investing activities of \$941 thousand resulted from \$950 thousand for additional investments offset by receipt of \$9 thousand in investment and interest income.

Capital Assets

At June 30, 2018, the Research Foundation had \$67.9 million in capital assets, less accumulated depreciation of \$27.1 million, for net capital assets of \$40.8 million. Depreciation expense totaled \$2.8 million and \$2.7 million for the fiscal years ended June 30, 2018 and 2017, respectively.

The following table summarizes the Research Foundation's capital assets, net of accumulated depreciation, as of June 30:

	<u>2018</u>	<u>2017</u>
Land	\$ 8,739,633	\$ 8,739,633
Construction in process	181,920	47,487
Buildings, net	31,508,251	33,407,783
Equipment, net	392,556	692,695
Total capital assets, net	<u>\$ 40,822,360</u>	<u>\$ 42,887,598</u>

Debt Administration

At June 30, 2018, the Research Foundation had \$18.9 million in outstanding debt representing a decrease of \$1.6 million, or 7.8%, from the prior fiscal year balance of \$20.5 million.

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

YEAR ENDED JUNE 30, 2018

Economic Factors That Will Affect the Future

The Research Park is finding success with its mission of creating an environment that fosters collaboration and innovation as evidenced by the number of academic research facilities on site alongside the many private sector facilities from nascent start-ups to the publicly traded. The private sector tenants continue to demonstrate positive job creation, collaboration with University faculty, licensing of university intellectual property, and real world internship opportunities for students.

Leases for existing structures and ground lease transactions within the Research Park are a significant source of revenue for the Research Foundation. Occupancy within the Research Park is at near capacity. While there is on-going risk of lease terminations, there continues to be encouraging interest in available space. Further growth is dependent on marketing efforts and market conditions, as we work on opportunities for constructing new facilities.

Request for Information

This financial report is designed to provide a general overview of the Research Foundation's finances for all those interested. Questions concerning any of the information provided in this report, or requests for additional information should be addressed in writing to the Chief Financial Officer, USF Research Foundation, Inc., 3802 Spectrum Blvd., Suite 100, Tampa, FL 33612.

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.
STATEMENT OF NET POSITION

JUNE 30, 2018

ASSETS

Current Assets:

Cash	\$ 4,977,490
Investments	34,544,101
Accounts receivable, net	1,437,093
Notes receivable, net	157,500
Other current assets	135,028
Total Current Assets	41,251,212

Noncurrent Assets:

Restricted cash	1,100,000
Capital assets, net	40,822,360
Developer rights to Research Park, net	7,225,154
Other investments	322,037
Noncurrent receivables	37,595
Notes receivables, net	266,013
Total Noncurrent Assets	49,773,159
Total Assets	91,024,371

DEFERRED OUTFLOWS OF RESOURCES

Derivative investment - interest rate swap	58,610
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LIABILITIES

Current Liabilities:

Accounts payable and accrued liabilities	1,677,338
Due to University of South Florida	7,751,530
Current portion of notes payable	1,720,000
Unearned revenues	166,514
Total Current Liabilities	11,315,382

Noncurrent Liabilities:

Notes payable, less current portion	17,155,000
Derivative investment - interest rate swap liability	58,610
Total Noncurrent Liabilities	17,213,610
Total Liabilities	28,528,992

NET POSITION

Net investment in capital assets	23,047,360
Unrestricted	39,506,629
Total Net Position	\$ 62,553,989

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION

YEAR ENDED JUNE 30, 2018

Operating Revenues:	
Property rental revenues	\$ 7,441,994
Royalties, licenses, and option fees	4,034,562
Incubator sponsor revenue	1,269,950
Incubator program revenue	604,561
Contracts and grants	325,524
Administrative fees	216,796
Total Operating Revenues	<u>13,893,387</u>
Operating Expenses:	
Property rental expenses	5,606,590
Incubator program expenses	1,383,587
Inventor royalties	1,089,385
Inventing department and other royalties	985,916
Other intellectual property costs	566,689
Contracts and grants	325,524
University support	83,790
Seed capital expense	25,000
Management and general	954,090
Total Operating Expenses	<u>11,020,571</u>
Operating Income	<u>2,872,816</u>
Nonoperating Revenue (Expense):	
Investment income	3,117,270
Interest income	26,865
Interest expense	(686,889)
Total Net Nonoperating Revenue	<u>2,457,246</u>
Increase in net position	5,330,062
Total net position, beginning of year	<u>57,223,927</u>
Total net position, end of year	<u><u>\$ 62,553,989</u></u>

The accompanying notes to the financial statements are an integral part of this statement.

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.
STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2018

Cash flows from operating activities:	
Property rental receipts	\$ 6,987,527
Royalties, licenses, and option fees	4,192,329
Contract and grant receipts	200,670
Administrative fee receipts	216,796
Incubator program and sponsor receipts	1,732,208
Total Receipts	<u>13,329,530</u>
Property rental disbursements	(2,791,357)
Intellectual property disbursements	(2,809,126)
Contract and grant disbursements	(658,721)
Incubator program disbursements	(1,089,385)
University support, management and general	(897,876)
Total Disbursements	<u>(8,246,465)</u>
Net cash flows from operating activities	<u>5,083,065</u>
Cash flows from capital and related financing activities:	
Acquisition of capital assets	(725,808)
Principal payments on notes payable	(1,590,000)
Interest paid on notes and swap liabilities	(641,325)
Note receivable paid	33,487
Issuance of notes receivable	(50,000)
Net cash flows from capital and related financing activities	<u>(2,973,646)</u>
Cash flows from investing activities:	
Sale of investments	50,000
Purchase of investments	(1,000,450)
Investment income	9,405
Net cash flows from investing activities	<u>(941,045)</u>
Net increase in cash	1,168,374
Cash, beginning of year	4,909,116
Cash, end of year	<u>\$ 6,077,490</u>
Cash:	
Unrestricted	\$ 4,977,490
Restricted	1,100,000
	<u>\$ 6,077,490</u>

(continued)

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.
STATEMENT OF CASH FLOWS (CONTINUED)

YEAR ENDED JUNE 30, 2018

**Reconciliation of net operating revenues (expenses)
to net cash flows from operating activities:**

Operating income	\$ 2,872,816
Adjustments to reconcile operating income to net cash flows from operating activities:	
Depreciation and amortization expense	2,906,958
Accounts receivable provision for bad debts	40,343
Notes receivable provision for net realizable value	25,000
Change in assets and liabilities:	
Accounts receivable and other receivables	(505,394)
Other current assets	(61,129)
Accounts payable and accrued liabilities	234,225
Due to University of South Florida	(266,552)
Unearned revenue	(163,202)
Net cash flows from operating activities	<u>\$ 5,083,065</u>

Supplemental disclosure of noncash capital and financing activities:

Reduction in derivative investments through a reduction in deferred outflow of resources for the interest rate swap	<u>\$ 97,997</u>
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Supplemental disclosure of noncash Investing activities:

Net unrealized gain on investments	<u>\$ 3,114,323</u>
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UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.

NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2018

Note 1—Organization

Nature of Entity – The University of South Florida Research Foundation, Inc. (the “Research Foundation”) was established to promote, encourage, and enhance the research activities of University of South Florida faculty, staff, and students. The Research Foundation provides a mechanism for the funding of licensed research and development activities at the University of South Florida (the “University”). The Research Foundation is a direct support organization of the University as provided for under Section 1004.28, Florida Statutes.

The Research Foundation owns and manages real property assets that include the USF Research Park and various buildings located on the property. Activities within the USF Research Park generate revenue primarily through long-term leases of facilities utilized by the University research enterprise and private sector entities seeking research relationships with the University.

The Research Foundation provides a broad and flexible financial mechanism to administer private research contracts and grants, including corporate and private foundation-sponsored programs. The Research Foundation assists the University in the commercialization of University inventions including license agreements, and receipt and distribution of royalties related to intellectual property. The Research Foundation works in cooperation with the University’s Technology Transfer Office/Patents and Licensing (“Patents and Licensing”) in obtaining the rights to patents and copyrights for these properties, and licensing them to commercial enterprises. Revenues generated from the commercialization of intellectual property include license fees, options-to-license fees, and royalties. Net revenue from the commercialization of the intellectual property are shared on a percentage basis among the inventors, a research fund in the department where the inventor is employed, a research fund for the college, and the Research Foundation. Net proceeds from Research Foundation activities are used to further research and other endeavors at the University.

Patents and Licensing reviews all intellectual property developed at the University to determine if the University wishes to retain its rights and interests. On intellectual work that shows the potential for University benefit, Patents and Licensing obtains patents and copyrights and assumes all costs, to include attorneys’ fees and patent application fees. All rights are retained by the University. The rights, title and interest in and to the intellectual property are then licensed by the University to the Research Foundation. Patent costs recovered by the Research Foundation are repaid to the University.

Reporting Entity – Criteria for defining the reporting entity are identified and described in the Governmental Standards Accounting Board’s (“GASB”)’s *Codification of Governmental Accounting and Financial Reporting Standards*, Section 2100 and 2600. These criteria were used to evaluate potential component units for which the primary government is financially accountable and other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the primary government’s financial statements to be misleading or incomplete. Based on the application of these criteria, the Research Foundation is a component unit of the University, and its financial balances and activity are reported in the University’s Comprehensive Annual Financial Report by discrete presentation.

Blended Component Units – Based on the application of the criteria for determining component units, CAUSF Research, LLC is included within the Research Foundation’s reporting entity as a blended component unit. CAUSF Research, LLC was established in 2004 as a financing vehicle for construction of a research building. The Research Foundation is the sole member of the LLC. In the current year, there was no activity in CAUSF Research, LLC to include in the reporting entity’s basic financial statements.

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.

NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2018

Note 2—Summary of significant accounting policies

Basis of Presentation – The financial statements of the Research Foundation conform to accounting principles generally accepted in the United States of America as prescribed by GASB. The Research Foundation financial statements are presented in the form of a single enterprise fund.

Basis of Accounting – The financial statements of the Research Foundation have been prepared using the flow of economic resources measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred.

Cash – The Research Foundation considers all highly liquid investments with a maturity of three months or less when purchased to be cash and cash equivalents.

Investments – Investments in money market accounts, short term bond index funds, equity securities, mutual funds, partnership accounts, and pooled accounts are recorded at fair value, as determined by quoted market prices. All investment income of the Research Foundation, including changes in the fair value of investments, is reported under nonoperating revenues in the statements of revenues, expenses and changes in net position.

Accounts Receivable – Accounts receivable are recorded at net realizable value. The Research Foundation's policy is to provide an allowance for accounts receivable that are not expected to be collected based on aging of the account and specific review of the customer.

Accounts receivable are charged off against the allowance for doubtful accounts when it is determined that the receivable will not be collected. The Research Foundation does not typically charge interest on past-due receivables and does not require collateral for accounts receivable.

Notes Receivable – Notes receivable consists of amounts funded to companies through the Seed Capital Accelerator Program (see Note 7) and are recorded at net realizable value. The Research Foundation's policy is to record a provision equaling approximately 50% of the outstanding note balance, for estimated net realizable value in consideration of conversion features associated with the note.

Restricted Cash – Cash whose use is restricted for debt service is segregated on the statement of net position.

Capital Assets – Purchased capital assets are recorded at cost. Donated capital assets are recorded at acquisition value at the date of the donation. Buildings are depreciated on a straight-line basis using estimated useful lives generally ranging from 30 to 39.5 years. Consistent with University policy, depreciation of research buildings is based on componentization over the estimated useful life of its components which range from 15 to 40 years. Equipment is depreciated on a straight-line basis over estimated useful lives ranging from 5 to 20 years.

Costs of donated assets greater than \$5,000 are capitalized. The cost of maintenance and repair of capital assets is charged to expense as incurred, while costs of renewals and betterments are capitalized. When capital assets are replaced, retired, or otherwise disposed of, the costs of such capital assets and the related accumulated depreciation are deducted from the respective asset and accumulated depreciation accounts.

Effective July 1, 2017, the Research Foundation implemented GASB 89 *Accounting for Interest Costs Incurred before the End of a Construction Period*. There was no effect on the financial statement amounts as a result of this implementation.

Deferred Outflows of Resources – In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element represents a consumption of net position that applies to a future period and will not be recognized as an expense until that time. The Research Foundation's interest rate swap agreement (see Note 10) meets this criterion.

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.

NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2018

Note 2—Summary of significant accounting policies (continued)

Income Taxes – The Research Foundation has been recognized by the Internal Revenue Service as a tax-exempt organization described in Section 501(c)(3) of the Internal Revenue Code and Chapter 220.13 of the Florida Statutes, respectively.

Revenue Recognition – Revenues associated with the license of intellectual properties are recognized in accordance with timing stipulated in license agreements and when determinable and collectable. The Research Foundation must be able to and be reasonably expected to enforce payment of contract fees before revenues are recognized.

Rental income is recognized when billed in accordance with the underlying lease agreement. In agreements where rent holidays are provided to the lessee, the Research Foundation recognizes rent on a straight-line basis. The effects of scheduled future minimum rent increases are recognized at the time they become effective.

Administrative fees from contracts and grants are deemed to be earned when the Research Foundation has incurred expenditures in compliance with the specific agreement terms. Funds received for which expenditures have not yet been made are recorded on the statement of net position as due to the University of South Florida or as unearned revenue if the Research Foundation is named as the contracting party.

Estimates – The preparation of financial statements in accordance 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, deferred outflows of resources, 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.

Subsequent Events – The Research Foundation evaluated all events and transactions that occurred from July 1, 2018 through October 2, 2018, the date the financial statements were available for issuance.

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.
NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2018

Note 3—Investments and other investments

At June 30, 2018, the Research Foundation has the following investments and maturities:

	Years				
	Fair Market Value	Less Than 1	1-5	6-10	More Than 10
Money Market Accounts	\$ 181,252	\$ 181,252	\$ -	\$ -	\$ -
Short-Term Corporate Bond Index Funds	2,962,187	-	2,959,225	2,962	-
Bonds	1,215,919	69,033	195,519	278,588	672,779
Equity Securities	1,551,866	No Maturity			
Mutual Funds	3,715,564	No Maturity			
Partnership Accounts	150,000	No Maturity			
Pooled Investments:					
Money Market Funds	471,123	471,123	-	-	-
Bond Mutual Funds	3,153,258	-	-	3,153,258	-
Partnership Funds	4,838,095	No Maturity			
Equity Mutual Funds	16,626,874	16,626,874	-	-	-
	<u>\$ 34,866,138</u>	<u>\$ 17,348,282</u>	<u>\$ 3,154,744</u>	<u>\$ 3,434,808</u>	<u>\$ 672,779</u>

Pooled investments represent the Research Foundation's interest in the University of South Florida Foundation's Agency Investment Program (the "Program"). The Program consists of an agency investment fund (the "Fund") which includes USF Foundation funds as well as funds invested by the Research Foundation and other University Direct Support Organizations. No specific investments are assigned to the Research Foundation, rather the value of the Research Foundation's investment is equal to the total Fund net asset value times the Research Foundation's units as a percentage of total units outstanding.

The Program pays a quarterly dividend based on the results of the Fund. Such dividends can either be withdrawn or reinvested. In addition, with 60-days' notice, the Research Foundation may withdraw either a portion of or its entire investment in the Program; however, the Research Foundation is limited to one withdrawal, other than any quarterly dividend, per calendar year. There were no unfunded commitments related to the Program as of June 30, 2018.

Other Investments – Other investments include equity holdings acquired from executed intellectual property agreements as well as other investments made in support of research efforts. Investments are recorded at fair value.

Concentration of Credit Risk – Concentration of credit risk is the risk of loss attributed to the magnitude of the Research Foundation's investment in a single issuer. The Research Foundation's investment policy provides that the maximum amount that may be invested in the securities of an individual issuer not backed by the full faith and credit of the U.S. government shall not exceed 5% of the market value of its investment portfolio. Direct investments in securities of the U.S. government, government agencies and State of Florida Investment Pools, or Pooled Funds comprised solely of U.S. government securities are not subject to these restrictions.

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.
NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2018

Note 3—Investments and other investments (continued)

Custodial Credit Risk – Custodial credit risk is the risk of loss attributed to the magnitude of the Research Foundation’s investments held by outside parties. At June 30, 2018, the book balances of cash funds were \$6,077,490 and the bank balances were \$6,431,582. The Research Foundation’s bank balances are insured by the Federal Deposit Insurance Corporation up to \$250,000. The Research Foundation from time to time may have amounts in excess of insured limits. At June 30, 2018, the Research Foundation had bank balances of \$6,181,582 in excess of these insured limits.

Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Research Foundation has responded to this risk and has an investment in a short-term bond index fund. Overall, the Research Foundation limits the fixed income portfolio (United States Treasury securities, United States government agency obligations, mortgage-backed securities, corporate debt, state and municipal securities investments) to a weighted average duration of less than five years. The Research Foundation’s investment policy provides for interest rate risk. The risk varies depending on the type of investment.

Credit Risk – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Research Foundation’s investment policy provides that all fixed income security investments at time of purchase, shall be rated in the top three rating classifications as defined by both Moody’s Investors Services and Standard & Poor’s or First Tier consistent with SEC rule 2a-7 if not rated and being no load funds. Eligible investments for long-term funds authorize pooled funds which are professionally managed and registered with the Securities and Exchange Commission, and invested in various indexed and actively managed funds. The Research Foundation’s investment policy provides for credit rate risk. The risk varies depending on the type of investment.

At June 30, 2018, the Research Foundation has the following debt instrument quality ratings:

	Fair Market Value	AAA	AA	A	Less Than A Rated	Not Rated
Money Market Accounts	\$ 652,375	\$ -	\$ -	\$ -	\$ -	\$ 652,375
Short-Term Bond Index	2,962,187	35,546	349,538	1,309,287	1,267,816	-
Bonds	1,215,919	234,432	93,463	237,414	160,862	489,748
Mutual Funds	3,715,564	-	-	-	-	3,715,564
Bond Mutual Funds	3,153,258	229,609	62,437	228,770	1,325,710	1,306,732
	<u>\$ 11,699,303</u>	<u>\$ 499,587</u>	<u>\$ 505,438</u>	<u>\$ 1,775,471</u>	<u>\$ 2,754,388</u>	<u>\$ 6,164,419</u>

Debt instruments whose quality is not rated includes \$1,683,312 of U.S. government/agency, \$23,771 of not rated short-term investments, \$652,375 of not rated money market funds, and \$3,804,961 otherwise not rated securities.

Investments, Investment Valuation, and Income Recognition – Investments are reported at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value determinations, other than those measured using the net asset value (“NAV”) as a practical expedient, are made based upon a hierarchy that prioritizes the inputs to valuation techniques. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements).

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.
NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2018

Note 3—Investments and other investments (continued)

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

Level 2 – Inputs include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; 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. If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 – Inputs to the valuation methodology are unobservable inputs in situations where there is little or no market activity for the asset or liability, and the reporting entity makes estimates and assumptions related to the pricing of the asset or liability including assumptions regarding risk.

The asset's or liability'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.

Following is a description of the valuation methodologies used for assets and liabilities measured at fair value:

Money Market Accounts – The fair value of these short-term investments is classified as Level 1 based on quoted prices in an active market.

Short Term Corporate Bond Index Fund – Valued on quoted prices in an active market, classified Level 1.

Bonds – Includes Corporate Obligations and U.S. Government/Agency Bonds that are valued on quoted prices, classified as Level 2.

Equity Securities – Valued on quoted prices in an active market, classified as Level 1.

Mutual Funds – Includes Level 1 Fixed Income and Equity Mutual Funds valued on quoted prices in an active market.

Partnership Accounts – Valued using the cost approach, classified as Level 3.

Pooled Investments – This investment is valued using the NAV provided by the administrator of the fund, as a practical expedient. The NAV is based on the value of the underlying assets owned by the fund, minus its liabilities, and then divided by the number of shares outstanding. The NAV is excluded from the valuation hierarchy.

Interest Rate Swaps – Valued using third party models and therefore are considered Level 3.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Research Foundation believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.
NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2018

Note 3—Investments and other investments (continued)

The following table sets forth by level, within the fair value hierarchy, the Research Foundation's investments carried at fair value as of June 30, 2018.

	Total Fair Value	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
Investments by Fair Value Level				
Money Market Accounts	\$ 181,252	\$ 181,252	\$ -	\$ -
Short-Term Corporate Bond Index Funds	2,962,187	2,962,187	-	-
Bonds	1,215,919	-	1,215,919	-
Equity Securities	1,551,866	1,551,866	-	-
Mutual Funds	3,715,564	3,715,564	-	-
Partnership Accounts	150,000	-	-	150,000
Total Investments by Fair Value Level	\$ 9,776,788	\$ 8,410,869	\$ 1,215,919	\$ 150,000
Investments Measured at NAV				
Pooled Investments	25,089,350			
Total Investments Measured at NAV	25,089,350			
Total Investments	\$ 34,866,138			
Investment Derivative Instruments				
Interest Rate Swap Agreement	\$ 58,610		\$ 58,610	
Total Investment Derivative Instruments	\$ 58,610		\$ 58,610	

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.
NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2018

Note 4—Accounts receivable

Accounts receivable consist of the following at June 30, 2018:

Royalty and license fees	\$ 1,321,000
Incubator sponsor support	200,000
Property leases	80,056
Other receivables	4,622
Allowance for doubtful accounts	(168,585)
	<u>\$ 1,437,093</u>

Note 5—Capital assets

Capital assets consist of the following at June 30, 2018:

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Capital assets not being depreciated:				
Land	\$ 8,739,633	\$ -	\$ -	\$ 8,739,633
Construction in process	47,487	181,918	(47,485)	181,920
Total capital assets not being depreciated	<u>8,787,120</u>	<u>181,918</u>	<u>(47,485)</u>	<u>8,921,553</u>
Capital assets being depreciated:				
Buildings	55,044,090	536,879	-	55,580,969
Equipment	3,303,422	54,496	-	3,357,918
Total capital assets being depreciated	<u>58,347,512</u>	<u>591,375</u>	<u>-</u>	<u>58,938,887</u>
Less accumulated depreciation for:				
Buildings	(21,636,307)	(2,436,411)	-	(24,072,718)
Equipment	(2,610,727)	(354,635)	-	(2,965,362)
Total accumulated depreciation	<u>(24,247,034)</u>	<u>(2,791,046)</u>	<u>-</u>	<u>(27,038,080)</u>
Total capital assets being depreciated, net	<u>34,100,478</u>	<u>(2,199,671)</u>	<u>-</u>	<u>31,900,807</u>
Total capital assets, net	<u>\$ 42,887,598</u>	<u>\$ (2,017,753)</u>	<u>\$ (47,485)</u>	<u>\$ 40,822,360</u>

Note 6—Developer rights to Research Park

Other noncurrent assets include development rights for the 87.32 acre USF Research Park of Tampa Bay, formerly known as the University Technology Center, which the Research Foundation has accounted for as a prepaid lease of \$8,384,270 net of accumulated amortization of \$1,159,116. The intent of the Board of Trustees of the Internal Improvement Trust Fund, when granting these rights, was for a research and development park to be at the entrance to the University campus. While it is expected that the development rights will be renewed beyond the current 2081 expiration, the value of the rights are being amortized on a straight line basis over 72 years. Annual amortization expense was \$115,912 for fiscal year 2018.

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.
NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2018

Note 7—Notes receivable Seed Capital Accelerator Program

In fiscal year 2014, the Board of Directors of the Research Foundation approved the establishment of the seed capital accelerator committee to assist the Board of Directors in fulfilling responsibilities regarding the venture investment fund which had been established by the Board of Directors in 1996.

An initial allocation of \$100,000 plus 25% of annual long-term investment income establishes the financial basis of the venture investment fund. During fiscal year 2018, investment gains of \$3,072,932 were recognized and accordingly, \$768,233 was allocated to the fund during the year. The balance of the venture investment fund is \$4,629,150 at June 30, 2018.

The purpose of the venture investment fund had been to assist faculty in development and business activities in which the Research Foundation may participate in future revenues generated from the commercialization of the projects. The Seed Capital Accelerator Program has been designed to support new and existing USF Tampa Bay Technology Incubator program (“Incubator program”) affiliated start-up companies that have been formed, based on the licensing of University technologies.

The Seed Capital Accelerator Program provides up to \$50,000 of loan funding to enable start-ups to quickly improve the odds of overcoming immediate obstacles to commercialization that would provide a measureable outcome and return on investment in the near term. The companies execute convertible promissory notes in an aggregate principal amount of up to \$50,000. The maturity date of each note is five years from initial closing date and the interest rate on each note is fixed at an annual rate equal to the Wall Street Journal prime rate plus 3% as of the date of the first advance. The notes are recorded at net realizable value of \$423,513 on the statement of net position, to include current portion of \$157,500 and noncurrent receivables of \$266,013.

During fiscal year 2018, the Seed Capital Accelerator Program provided funding of \$50,000 to one company.

The following is a schedule of maturities:

<u>Year</u>	<u>Notes Receivable</u>	<u>Reserve</u>	<u>Net</u>
2019	\$ 339,500	\$ (182,000)	\$ 157,500
2020	150,000	(75,000)	75,000
2021	205,000	(113,987)	91,013
2022	150,000	(75,000)	75,000
2023	50,000	(25,000)	25,000
	<u>\$ 894,500</u>	<u>\$ (470,987)</u>	<u>\$ 423,513</u>

Note 8—Accounts payable and accrued liabilities

Accounts payable and accrued liabilities consist of the following at June 30, 2018:

Vendors payable	\$ 517,261
Inventor royalties payable	697,076
Escrow payable	273,141
Interest payable	55,215
Other payables	134,645
	<u>\$ 1,677,338</u>

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.
NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2018

Note 9—Long-term debt

In 1999, the Research Foundation issued a Variable Rate Demand Revenue Bond (USF Research Park of Tampa Bay Project) Series 1999 (“1999 Bond”), to finance and refinance capital improvements at the University Technology Center Research and Development Park, now referred to as the USF Research Park of Tampa Bay. In addition thereto, the remaining acquisition of development rights to 35 acres of land was completed, existing University Technology Center Buildings I and II, now referred to as buildings 3702 Spectrum and 3650 Spectrum, and previously acquired development rights to lots 6 and 7 in the Research Park were refinanced. The 1999 Bond was issued pursuant to a Trust Indenture dated November 23, 1999, between the Research Foundation and the Trustee. The USF Foundation has guaranteed the indebtedness of the Research Foundation relative to the 1999 bond.

In 2004, the Research Foundation financed construction of the 3720 Spectrum building and 3802 Spectrum building through the issuance of Variable Rate Demand Revenue Bonds Series 2004A, B, and C (“2004 bonds”). The closing of the 2004 bonds was completed in August 2004.

In 2013, the Research Foundation issued Series 2013-A Note to refund the outstanding Series 1999 Bond. The terms of the note include an interest rate of 67% of One-Month USD-London Interbank Offer Rate (“LIBOR”), to be payable monthly. The interest rate was 3.14% at June 30, 2018. Principal is payable annually. The Note matures December 1, 2019 and is secured by lease assignments in addition to the USF Foundation guarantee.

In 2013, the Research Foundation issued Series 2013-B Note to refund the outstanding Series 2004A Bond. In fiscal year 2017, the note was amended to a 10-year fixed rate note. The existing amortization schedule through 2034 was maintained. Interest at 3.18% fixed rate is payable monthly, with principal payable annually. The Note matures August 1, 2034 and is secured by lease assignments.

	<u>June 30, 2017</u>	<u>Increases</u>	<u>Reductions</u>	<u>June 30, 2018</u>	<u>Amounts Due Within One Year</u>
Notes Payable:					
2013-A	\$ 2,900,000	\$ -	\$ (900,000)	\$ 2,000,000	\$ 1,000,000
2013-B	17,565,000	-	(690,000)	16,875,000	720,000
Total Notes Payable	<u>\$ 20,465,000</u>	<u>\$ -</u>	<u>\$ (1,590,000)</u>	<u>\$ 18,875,000</u>	<u>\$ 1,720,000</u>

The credit agreement includes a liquidity to funded debt ratio covenant requirement whereby liquid assets of cash, restricted cash and equivalents plus investments to indebtedness for money borrowed, not be less than .40 to 1.00.

At June 30, 2018, \$1,100,000 of funds is on deposit with the bank in sinking fund accounts for payment of annual principal payments. These amounts have been reported in restricted cash on the statement of net position.

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.
NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2018

Note 9—Long-term debt (continued)

The following is a schedule of maturities and total interest expense, to include the interest rate swap agreement, as further discussed in note 10:

Year	Maturities	Interest
2019	\$ 1,720,000	\$ 624,717
2020	1,745,000	564,931
2021	775,000	467,447
2022	805,000	441,927
2023	835,000	415,454
2024 - 2028	4,705,000	1,668,506
2029 - 2033	5,690,000	803,878
2034 - 2035	2,600,000	49,025
	<u>\$ 18,875,000</u>	<u>\$ 5,035,885</u>

Future obligations of interest expense, to include the interest rate swap agreement, are based on the fixed and variable rates in effect as of June 30, 2018, and may not be representative of actual rates in those later periods.

Total interest expense which includes interest for the notes and interest rate swap agreement, as further discussed in Note 10, was \$686,889 for fiscal year 2018.

Note 10—Derivative instruments

In 2001 and in 2006, the Research Foundation entered into interest rate swap agreements to limit the effects of changes in interest rates on its variable rate debt (see Note 9). In conjunction with the 2013 refunding of the 1999 and 2004 bonds, and the reissuance of 2013 Series Notes with a new bank, an intercreditor agreement with the counterparty to the swap agreements was entered into. At June 30, 2018, only the 2001 swap agreement (Series 2013-A) remains in effect.

The terms of the swap agreement provide the Research Foundation to pay a monthly fixed rate and receive monthly a variable rate equal to 67% of the one-month LIBOR. The effect of the agreement was to set the interest rate at a fixed rate through the term of the swap agreement.

As interest rates have continued to decline since the Research Foundation entered into the swap agreement, the swap agreement has a negative fair value as of June 30, 2018 and as such, is presented as a noncurrent liability in the accompanying statement of net position. The fair value of the swap agreement is estimated taking into account current interest rates and the credit worthiness of the counterparties. The reported fair value is calculated using the marked-to-market method by an independent third party.

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.
NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2018

Note 10—Derivative instruments (continued)

The fair value and key terms of the Research Foundation’s swap agreement at June 30, 2018 are as follows:

Notes	Notional Amount	Effective Date	Maturity Date	Fixed Rate	Estimated Fair Value
Series 2013-A	\$ 2,000,000	06/01/01	12/01/19	4.560%	\$ (58,610)

Credit Risk – Because the swap has a negative fair value, the Research Foundation is exposed to the credit risk of Bank of America, NA in the amount of the swap’s fair value. Bank of America has ratings of Aa-3 (long-term) and P-1 (short-term) by Moody’s Investors Services, and A+ (long-term) and A-1 (short-term) by Standard & Poor’s.

Termination Risk – The swap does not contain any out-of-the-ordinary termination events that would expose the Research Foundation to significant termination risk.

Total interest expense as disclosed in Note 9 includes interest under terms of the swap agreement of \$84,285 for fiscal year 2018.

The following is a schedule of expected future interest payments required under the swap agreement as of June 30, 2018:

Year	Amount
2019	\$ 64,600
2020	19,000
	<u>\$ 83,600</u>

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.
NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2018

Note 11—Property rental revenues

The Research Foundation leases grounds, office, and laboratory space to customers, primarily in the technology research and development industry, under operating leases. Initial lease terms generally range from 36 to 120 months.

Investments in assets subject to operating leases are as follows at June 30, 2018:

Buildings, at cost	\$ 54,815,122
Accumulated depreciation	<u>(23,695,548)</u>
Net investments in assets subject to operating leases	<u><u>\$ 31,119,574</u></u>

Depreciation expense related to the buildings leased to other parties was \$2,363,179 for fiscal year 2018.

Future minimum lease payments expected to be received under noncancellable operating leases as of June 30, 2018 are as follows:

<u>Year</u>	<u>Total Amount</u>	<u>Related Party</u>
2019	\$ 7,770,492	\$ 7,118,018
2020	7,535,099	7,030,274
2021	7,202,170	6,851,475
2022	5,941,774	5,876,509
2023	5,744,283	5,679,018
Thereafter	<u>51,569,300</u>	<u>47,783,930</u>
	<u><u>\$ 85,763,118</u></u>	<u><u>\$ 80,339,224</u></u>

Note 12—Related party transactions

The Research Foundation leases a building to the University under a master lease agreement through 2036 or the expiration of the long-term debt, if earlier (see Note 9). Operating leases for other research laboratories and office space, which expire through fiscal year 2023, are also in effect with various departments of the University. Total rent revenues from the University were \$6,460,448 for fiscal year 2018.

The Research Foundation invoices intellectual property licensees for reimbursement of patent costs that are due to the University. Total amounts invoiced of \$580,933 for patent costs recovery in fiscal year 2018 are not reflected in the accompanying statement of revenues, expenses, and changes in net position. In fiscal year 2018, the Research Foundation paid \$883,002 to the University for patent costs recovered from intellectual property receipts. Outstanding receivables from licensees for reimbursement of patent costs, and payables to the University for accrued patent costs, a net liability of \$205,654, are included in the due to University of South Florida payable in the statement of net position.

On behalf of the University, the Research Foundation manages the fiscal operations and services of the Incubator program. During fiscal year 2018, the Research Foundation received \$700,000 from the University in support of the Incubator program.

In accordance with agreements, the Research Foundation has custodial responsibility for post-award management of certain non-clinical contracts and grants on behalf of the University.

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.
NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2018

Note 12—Related party transactions (continued)

Post-award management includes processing sponsor invoicing and related expenditures for the contracts and grants. Expenditures processed through the Research Foundation in fiscal year 2018 totaled \$1,138,500, of which \$628,426 were disbursements made to the University. These contract and grant revenues and expenditures are not reflected in the accompanying statement of revenues, expenses, and changes in net position. The Research Foundation recognized administrative fee revenue in the amount of \$105,704 for these services in fiscal year 2018. The custodial fund balance for these agreements of \$509,277 is included in the due to University payable in the statement of net position.

By agreement with the University, the Research Foundation has custodial responsibility of proceeds received from sales of Graphicstudio artwork and processes disbursement of Graphicstudio's expenditures. During fiscal year 2018, \$1,004,357 of cash receipts and \$1,108,031 of disbursements were processed by the Research Foundation for benefit of Graphicstudio. These amounts are not reflected in the accompanying statement of revenues, expenses, and changes in net position. In fiscal year 2018, the Research Foundation received \$79,398 in administrative fees for these services. The custodial cash balance at June 30, 2018 of \$149,730 is included in the due to University of South Florida payable in the statement of net position.

Included in the due to University of South Florida payable in the statement of net position are Research funds held on behalf of University faculty, department, and colleges in the amount of \$4,434,618 as of June 30, 2018, that will be utilized to support their research and education activities. The Research Foundation distributes royalties from intellectual property net revenue to inventors, their departments and to colleges' research funds. During fiscal year 2018, the Research Foundation recognized royalty distribution expenses of \$328,375 and \$189,487 to the departments and colleges of the University research funds, of which \$380,374 and \$199,237 respectively, were distributed. Accrued royalties payable of \$289,286 are included in the due to University payable in the statement of net position.

Under agreements with the University, the Research Foundation is engaged to manage renovations of research facilities to support University research within the USF Research Park. At June 30, 2018, funding received in excess of costs incurred of \$327,504, is included in the due to University payable in the statement of net position.

As a direct service organization of the University, the Research Foundation will assume responsibility for various University initiatives. At June 30, 2018, total custodial funds of \$1,671,518, for varied initiatives are included in the due to University payable in the statement of net position.

The President of the Research Foundation is the co-founder and member of the board for two companies that each received a loan of \$50,000 in fiscal year 2014 as part of the Seed Capital Accelerator Program. The terms of the notes were consistent with the Seed Capital Accelerator Program as disclosed in Note 7. The maturity date of both notes occurs in fiscal year 2019.

All personnel of the Research Foundation are employees of the University with employee benefits and compensated absences accounted for on the University's books. The University tracks, administers, and reports all payroll and fringe benefit costs for Research Foundation personnel, which are then reimbursed to the University by the Research Foundation. In fiscal year 2018 salary and fringe benefit costs were \$1,411,759.

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.
NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2018

Note 13—Commitments

In fiscal year 2018, the Research Foundation entered into a five year lease commitment of office space, with rent payments commencing in September 2018. The lease expires in fiscal year 2024.

Future minimum lease payments expected to be paid under the noncancellable operating lease as of June 30, 2018 are as follows:

<u>Year</u>	<u>Amount</u>
2019	\$ 515,021
2020	627,770
2021	639,707
2022	651,943
2023	664,484
Thereafter	111,097
	<u>\$ 3,210,022</u>

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.
SCHEDULE OF FUNCTIONAL EXPENSES

YEAR ENDED JUNE 30, 2018

	Program Services	Management and General	Total
Depreciation expense	\$ 2,790,986	\$ 60	\$ 2,791,046
Royalty expense	1,552,605	-	1,552,605
Utilities	1,361,197	-	1,361,197
Technology costs	1,343,244	-	1,343,244
Repairs and maintenance	1,305,812	28,248	1,334,060
Salary and wages	603,445	597,646	1,201,091
Fringe benefits	166,663	207,121	373,784
Materials and supplies	248,394	17,181	265,575
Insurance	245,694	10,595	256,289
Amortization expense	115,912	-	115,912
Professional fees	35,339	74,910	110,249
Bad debt expense	65,343	-	65,343
Subscriptions and memberships	54,908	3,200	58,108
Independent contractors	56,589	-	56,589
Real estate tax	41,269	-	41,269
Telephone	18,531	10,211	28,742
Grant administrative fees	24,085	-	24,085
Travel	15,877	249	16,126
Bank fees	9,497	1,247	10,744
Advertising	4,203	-	4,203
Participant stipends and tuition	3,220	-	3,220
Rental expense	3,178	-	3,178
Postage and freight	37	2,183	2,220
Printing costs	453	1,239	1,692
Total Operating Expenses	\$ 10,066,481	\$ 954,090	\$ 11,020,571

**Report of Independent Auditor on Internal Control over
Financial Reporting and on Compliance and Other Matters
Based on an Audit of Financial Statements Performed in
Accordance with *Government Auditing Standards***

To the Board of Directors of
University of South Florida
Research Foundation, Inc.
Tampa, Florida

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the University of South Florida Research Foundation, Inc. (the "Research Foundation"), as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise the Research Foundation's basic financial statements, and have issued our report thereon dated October 2, 2018.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Research Foundation's internal control over financial reporting ("internal control") to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Research Foundation's internal control. Accordingly, we do not express an opinion on the effectiveness of the Research Foundation's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Research Foundation's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in black ink that reads "Cherry Bekant LLP". The signature is written in a cursive style with a large, sweeping initial "C".

Tampa, Florida
October 2, 2018