

**ORTHOPAEDIC RESEARCH AND  
EDUCATION FOUNDATION**

**FINANCIAL STATEMENTS**

**June 30, 2017 and December 31, 2016  
and for the Six Months and  
Twelve Months Then Ended**

**ORTHOPAEDIC RESEARCH AND  
EDUCATION FOUNDATION**

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# Desmond & Ahern, Ltd.

CERTIFIED PUBLIC ACCOUNTANTS & CONSULTANTS

## **Independent Auditor's Report**

To the Board of Trustees  
Orthopaedic Research and Education Foundation  
Rosemont, IL

We have audited the accompanying financial statements of Orthopaedic Research and Education Foundation (the Foundation), which comprise the statement of financial position as of June 30, 2017, and the related statements of activities and cash flows for the six month period 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 audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of 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 Orthopaedic Research and Education Foundation as of June 30, 2017 and the changes in its net assets and its cash flows for the six month period then ended in accordance with accounting principles generally accepted in the United States of America.

### ***Prior Period Financial Statements***

The financial statements of Orthopaedic Research and Education as of December 31, 2016, were audited by other auditors whose report dated May 22, 2017, expressed an unmodified opinion on those statements. As discussed in Note 14 to the financial statements, the Organization has adjusted its 2016 and 2015 financial statements to retrospectively correct certain errors resulting in the understatement of charitable remainder trust receivable discount. The other auditors reported on the financial statements before the retrospective adjustment.

As part of our audit of the 2017 financial statements, we also audited the adjustments to the 2016 and 2015 financial statements to retrospectively apply the correction of the error as described in note 14. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review or apply any procedures to the 2016 and 2015 financial statements other than with respect to the adjustments and accordingly, we do not express an opinion on any other form of assurance on the 2016 and 2015 financial statements taken as a whole.

*Desmond & Ahern, Ltd*

June 6, 2018  
Chicago, IL

**ORTHOPAEDIC RESEARCH AND EDUCATION FOUNDATION**  
**STATEMENTS OF FINANCIAL POSITION**  
**June 30, 2017 and December 31, 2016**

	June 30, 2017	December 31, 2016 (restated)
<b><u>Assets</u></b>		
Current Assets		
Cash and cash equivalents	\$ 1,967,694	\$ 2,957,339
Restricted cash	568,639	946,318
Pledges receivable, net	2,150,024	2,762,330
Other receivables	16,880	16,536
Prepaid expenses	39,908	67,186
Total current assets	<u>4,743,145</u>	<u>6,749,709</u>
Noncurrent Assets		
Pledge receivable - long-term	82,825	80,145
Marketable securities	13,180,695	11,645,516
Certificates of deposit	1,598,166	1,798,528
Cash surrender value of life insurance policies	2,231,684	2,156,437
Charitable remainder trusts receivable	2,765,159	2,726,475
Property and equipment, net	131,187	171,396
Total noncurrent assets	<u>19,989,716</u>	<u>18,578,497</u>
<b>Total Assets</b>	<u><u>\$ 24,732,861</u></u>	<u><u>\$ 25,328,206</u></u>
<b><u>Liabilities and Net Assets</u></b>		
Current Liabilities		
Grants and awards payable - current	\$ 1,916,427	\$ 2,172,626
Accounts payable	60,043	69,465
Accrued expenses	116,334	120,714
Due to orthopaedic partners	1,274,292	1,651,971
Total current liabilities	<u>3,367,096</u>	<u>4,014,776</u>
Noncurrent liabilities		
Grants and awards payable - long-term	774,611	635,360
Total noncurrent liabilities	<u>774,611</u>	<u>635,360</u>
Total liabilities	<u>4,141,707</u>	<u>4,650,136</u>
Net Assets		
Unrestricted	(2,505,922)	(2,497,081)
Temporarily restricted	6,775,392	6,877,343
Permanently restricted	16,321,684	16,297,808
Total net assets	<u>20,591,154</u>	<u>20,678,070</u>
<b>Total Liabilities and Net Assets</b>	<u><u>\$ 24,732,861</u></u>	<u><u>\$ 25,328,206</u></u>

See independent auditor's report and notes to financial statements.

**ORTHOPAEDIC RESEARCH AND EDUCATION FOUNDATION**  
**STATEMENTS OF ACTIVITIES**  
**For the Six Month Period Ended June 30, 2017**

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<b><u>Public Support and Revenue</u></b>				
Contributions	\$ 527,899	\$ 1,376,442	\$ 42	\$ 1,904,383
Contributions to endowments	-	-	10,681	10,681
Change in value of charitable remainder trusts receivable	-	19,634	19,050	38,684
Change in cash surrender value of life insurance policies	-	-	75,247	75,247
Investment return	193,769	-	-	193,769
Temporarily restricted net assets released from restrictions				
Expiration of time restrictions	122,451	(122,451)	-	-
Grant funding	1,114,076	(1,114,076)	-	-
Total public support and revenue	<u>1,958,195</u>	<u>159,549</u>	<u>105,020</u>	<u>2,222,764</u>
<b><u>Expenses</u></b>				
Program Expenses				
Grants and awards	1,300,727	-	-	1,300,727
Grants and awards administration	143,007	-	-	143,007
Total program expenses	<u>1,443,734</u>	<u>-</u>	<u>-</u>	<u>1,443,734</u>
Fundraising expenses	840,797	261,500	-	1,102,297
General and administrative expenses	472,053	-	-	472,053
Total expenses	<u>2,756,584</u>	<u>261,500</u>	<u>-</u>	<u>3,018,084</u>
Change in net assets before non-operating items	<u>(798,389)</u>	<u>(101,951)</u>	<u>105,020</u>	<u>(795,320)</u>
Non-Operating Items:				
Releases of permanently restricted net asset balances to orthopaedic partners	81,144	-	(81,144)	-
Investment gain on endowment assets	778,493	-	-	778,493
Orthopaedic partner endowment distributions	(70,089)	-	-	(70,089)
	<u>789,548</u>	<u>-</u>	<u>(81,144)</u>	<u>708,404</u>
<b>Change in Net Assets</b>	(8,841)	(101,951)	23,876	(86,916)
Net assets, beginning of year (restated)	<u>(2,497,081)</u>	<u>6,877,343</u>	<u>16,297,808</u>	<u>20,678,070</u>
Net assets, end of year	<u>\$ (2,505,922)</u>	<u>\$ 6,775,392</u>	<u>\$ 16,321,684</u>	<u>\$ 20,591,154</u>

See independent auditor's report and notes to financial statements.

**ORTHOPAEDIC RESEARCH AND EDUCATION FOUNDATION**  
**STATEMENTS OF ACTIVITIES**  
**For the Twelve Month Period Ended December 31, 2016**

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total (restated)
<b><u>Public Support and Revenue</u></b>				
Contributions	\$ 1,803,195	\$ 2,864,067	\$ 1,138	\$ 4,668,400
Contributions to endowments	-	-	47,424	47,424
Change in value of charitable remainder trusts receivable	-	(10,396)	(79,807)	(90,203)
Change in cash surrender value of life insurance policies	-	-	82,275	82,275
Investment return	388,517	-	-	388,517
Temporarily restricted net assets released from restrictions				
Expiration of time restrictions	248,227	(248,227)	-	-
Grant funding	1,736,886	(1,736,886)	-	-
Total public support and revenue	<u>4,176,825</u>	<u>868,558</u>	<u>51,030</u>	<u>5,096,413</u>
<b><u>Expenses</u></b>				
Program Expenses				
Grants and awards	1,816,210	-	-	1,816,210
Grants and awards administration	598,794	96,027	271,935	966,756
Total program expenses	<u>2,415,004</u>	<u>96,027</u>	<u>271,935</u>	<u>2,782,966</u>
Fundraising expenses	1,403,207	-	-	1,403,207
General and administrative expenses	979,535	-	-	979,535
Total expenses	<u>4,797,746</u>	<u>96,027</u>	<u>271,935</u>	<u>5,165,708</u>
Change in net assets before non-operating items	<u>(620,921)</u>	<u>772,531</u>	<u>(220,905)</u>	<u>(69,295)</u>
Non-Operating Items:				
Releases of permanently restricted net asset balances to orthopaedic partners	6,230,393	-	(6,230,393)	-
Investment gain on endowment assets	953,270	-	-	953,270
Orthopaedic partner endowment distributions	(5,132,563)	-	-	(5,132,563)
	<u>2,051,100</u>	<u>-</u>	<u>(6,230,393)</u>	<u>(4,179,293)</u>
<b>Change in Net Assets</b>	1,430,179	772,531	(6,451,298)	(4,248,588)
Net assets, beginning of year (restated)	<u>(3,927,260)</u>	<u>6,104,812</u>	<u>22,749,106</u>	<u>24,926,658</u>
Net assets, end of year	<u>\$ (2,497,081)</u>	<u>\$ 6,877,343</u>	<u>\$ 16,297,808</u>	<u>\$ 20,678,070</u>

See independent auditor's report and notes to financial statements.

**ORTHOPAEDIC RESEARCH AND EDUCATION FOUNDATION**  
**STATEMENTS OF CASH FLOWS**  
**For the Six Month Period Ended June 30, 2017**  
**and the Twelve Month Period Ended December 31, 2016**

	Six Months Ended June 30, 2017	Twelve Months Ended December 31, 2016 (restated)
<b><u>Cash Flows from Operating Activities</u></b>		
Change in net assets	\$ (86,916)	\$ (4,248,588)
Adjustments to reconcile change in net assets to net cash used by operating activities:		
Depreciation and amortization	40,209	13,217
Net unrealized (gains) losses on investments	(780,049)	(952,378)
Net realized (gains) loss on investments	(18,671)	41,956
Change in cash surrender value of life insurance policies	(75,247)	(82,275)
Change in charitable remainder trusts receivable	(38,684)	90,203
Bad debt expense	262,200	377,967
Distributions of orthopaedic partner endowments	70,089	5,132,563
Proceeds from permanently restricted contributions	(10,725)	(48,562)
Decrease (increase) in		
Pledges receivable	347,426	(222,745)
Other receivables	(344)	(32,198)
Prepaid expenses	27,278	(148,289)
Increase (decrease) in		
Grants and awards payable	(116,948)	112,182
Accounts payable	(9,422)	33,143
Accrued expenses	(4,380)	(108,623)
Due to orthopaedic partners	(377,679)	(622,467)
Net cash used by operating activities	<u>(771,863)</u>	<u>(664,894)</u>
<b><u>Cash Flows from Investing Activities</u></b>		
Decrease in restricted cash	377,679	622,467
Proceeds from sales of marketable securities	1,647,657	12,834,538
Purchases of marketable securities	(2,384,116)	(7,583,169)
Sales of certificates of deposit	200,362	-
Purchases of property and equipment	-	30,084
Net cash provided by investing activities	<u>(158,418)</u>	<u>5,903,920</u>

See independent auditor's report and notes to financial statements.

**ORTHOPAEDIC RESEARCH AND EDUCATION FOUNDATION**  
**STATEMENTS OF CASH FLOWS (CONT.)**  
**For the Six Month Period Ended June 30, 2017**  
**and the Twelve Month Period Ended December 31, 2016**

	Six Months Ended June 30, 2017	Twelve Months Ended December 31, 2016 (restated)
<b><u>Cash Flows from Financing Activities</u></b>		
Distributions of orthopaedic partner endowment	\$ (70,087)	\$ (5,132,563)
Proceeds from permanently restricted contributions	10,723	48,562
Net cash used by investing activities	<u>(59,364)</u>	<u>(5,084,001)</u>
<b>Net decrease in cash</b>	(989,645)	155,025
<b>Cash, beginning of year</b>	<u>2,957,339</u>	<u>2,802,314</u>
<b>Cash, end of year</b>	<u><u>\$ 1,967,694</u></u>	<u><u>\$ 2,957,339</u></u>

See independent auditor's report and notes to financial statements.

**ORTHOPAEDIC RESEARCH AND EDUCATION FOUNDATION**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2017 and December 31, 2016**

**Note 1 – Nature of Operations and Summary of Significant Accounting Policies**

Organization

The Orthopaedic Research and Education Foundation (OREF), founded in 1955 as an Illinois not-for-profit corporation, is a charitable 501(c)(3) organization committed to improving lives by supporting excellence in orthopaedic research. OREF is dedicated to being the leader in supporting research that improves function, eliminates pain and restores mobility, and is the premiere orthopaedic organization funding research across all specialties.

As the leading grant making resource for new investigators, OREF provides important financial support that helps them build a strong foundation for their research careers. This critical early support enables new investigators to generate the data and outcomes needed to secure larger grants from prestigious funding sources such as the National Institutes of Health (NIH) and the Department of Defense(DoD).

OREF also provides grant funding to established clinicians for whom other funding may be limited due to the area of research being pursued or funding shortfalls. In addition to financial support, OREF offers new investigators opportunities to establish mentor relationships with well-respected orthopaedic surgeons and to hone important skills such as those acquired through participation in grant writing workshops.

This summary of significant accounting policies is presented to assist in understanding the Foundation's financial statements. The financial statements and notes are representations of management who is responsible for their integrity and objectivity. These accounting policies conform to accounting principles generally accepted in the United States of America and have been consistently applies in the preparation of the financial statements.

Basis of Accounting

The accounts and financial statements are maintained on the accrual basis of accounting and accordingly, reflect all significant accounts receivable, payable, and other liabilities.

Basis of Presentation

The Foundation reports information regarding its financial position and activities according to three classes of net assets: unrestricted, temporarily restricted, and permanently restricted net assets, as required by accounting principles generally accepted in the United States of America (GAAP).

Use of Estimates

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

**ORTHOPAEDIC RESEARCH AND EDUCATION FOUNDATION**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2017 and December 31, 2016**

**Note 1 – Nature of Operations and Summary of Significant Accounting Policies (cont.)**

Grants and Awards Expenses

Grants and awards are expensed and a liability established when approved by the Research Grants Committee. These grants are paid over a one-to-three year period, based on the submission of grantee progress reports. Grants payable in excess of one year are recorded at net present value.

Cash and Cash Equivalents

Cash and cash equivalents are comprised of cash in banks and money market funds. The Foundation considers highly liquid short-term instruments with original maturities of three months or less to be cash equivalents.

Restricted Cash

Amounts collected by the Foundation which are intended for orthopaedic partners are presented as restricted cash on the statement of financial position and are offset by due to orthopaedic partners' liability.

Marketable Securities

Marketable securities, whether purchased or donated, are recorded at fair value. All gains and losses are included in the statement of activities. Unrealized gains or losses on such securities are based on the change in the market value of the assets from the beginning to the end of the fiscal year. Realized gains or losses are based on the change in the market value of the assets from the beginning of the fiscal year to the date of sale.

Investments are exposed to various risks, such as interest rate, market and credit risks. Due to the level of risk associated with certain investments, it is at least reasonably possible that changes in the values of investments will occur in the near term and that such changes could materially affect the Foundation and the amounts reported in the statement of activities.

Certificates of Deposit

The Foundation has eight certificates of deposit at June 30, 2017 with original costs of \$200,000 each, with maturities ranging from August 2017 through August 2018. All certificates of deposit are fully insured by the FDIC and are carried at their original cost.

Concentration of Credit Risk

The Foundation maintains cash and cash equivalents in certain financial institutions. At times during the year, balances at these institutions may exceed federally insured limits. The Foundation has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk on cash and cash equivalents.

**ORTHOPAEDIC RESEARCH AND EDUCATION FOUNDATION**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2017 and December 31, 2016**

**Note 1 – Nature of Operations and Summary of Significant Accounting Policies (cont.)**

Contributions

Contributions are recognized when received or when the donor makes an unconditional promise to give to the Foundation. Promises to give payable over more than one year are recorded at net present value. Contributions of cash and other assets are recorded as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or a purpose restriction is fulfilled, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. Permanently restricted contributions must be invested in perpetuity, the earnings from which are available to support the activities of the Foundation. Gifts of marketable securities are recorded as contributions at their fair value at the date of the gift.

As part of its fundraising activities, the Foundation solicits annual campaign donations on behalf of the orthopaedic partners. Contributions on the statement of activities do not include such funds as the Foundation is only an intermediary. Contributions received on behalf of orthopaedic partners totaled \$79,150 and 633,765 during the twelve month and six month periods ended June 30, 2017 and December 31, 2016, respectively. A total of \$1,274,292 and \$1,651,971 has not been remitted to these orthopaedic partners and is included on the statement of financial position as of June 30, 2017 and December 31, 2016, respectively.

In addition, the Foundation solicits contributions to its endowment that are to benefit the orthopaedic partners and other organizations. These contributions are recorded as permanently restricted contributions of the Foundation, and the earnings are allocated to the beneficiary organization annually.

Pledges Receivable

Unconditional promises to give are recognized as revenues in the period the promise is given. Pledges receivable are reported net of a present value discount and an allowance for doubtful pledges based on management's estimate of the collectability of identified receivables.

Property and Equipment

Property and equipment purchases of \$500 or more and with an expected useful life of three or more years are recorded at cost and depreciated over their estimated useful lives on a straight-line basis. Office furniture and equipment, and computer equipment and software are depreciated over five years. Leasehold improvements are amortized over the lesser of the useful life or the term of the lease.

Major renewals and betterments, which extend the useful life of an asset, are capitalized while routine maintenance and repairs are expensed as incurred. Gains or losses on dispositions of property and equipment are included in the statement of activities.

**ORTHOPAEDIC RESEARCH AND EDUCATION FOUNDATION**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2017 and December 31, 2016**

**Note 1 – Nature of Operations and Summary of Significant Accounting Policies (cont.)**

Functional Allocation of Expenses

The costs of providing the various programs and other activities have been summarized on a functions basis in the statement of activities. Expenses that are directly associated with a particular program or supporting service are charged directly to that functional area. Certain other costs have been allocated among the programs and supporting services benefited based on estimated of staff time devoted to the functional areas and other appropriate allocation methods determined by management.

Donated Services

A significant amount of donated services are contributed to the Foundation by various individuals to support the Foundation's program and supporting services. These volunteer activities include participation on the Board of Trustees and numerous other committees. The value of these services is not reflected in these financial statements since they do not meet the criteria for recognitions under the FASB Codification topic, Accounting for Contributions Received and Contributions Made.

Tax Status

The Foundation, an Illinois nonprofit corporation, is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code and applicable state law, except for taxes pertaining to unrelated business income, if any. The Foundation's annual information and income tax returns filed with the federal and state governments are subject to examination generally for three years after they are filed.

The Foundation has adopted the requirements for accounting for uncertain tax positions and management has determined that the Foundation was not required to record a liability related to uncertain tax positions as of June 30, 2017 and December 31, 2016.

Reclassifications

Certain amounts previously reported in the 2016 financial statements have been reclassified to conform to the 2017 presentation. These reclassifications had no effect on the prior year net assets.

Subsequent Events

Accounting principles generally accepted in the United States of America establish general standards of accounting for, and disclosure of, events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The Foundation has evaluated subsequent events through the date of the report on the financial statements, which is the date the statements were available to be issued. No subsequent events have been identified that are required to be disclosed as of that date.

**ORTHOPAEDIC RESEARCH AND EDUCATION FOUNDATION**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2017 and December 31, 2016**

**Note 2 – Marketable Securities and Investment Return**

At June 30, 2017 and December 31, 2016, the aggregate amounts of marketable securities by major type recorded at fair value were as follows:

	<u>June 30, 2017</u>	
	<u>Fair Value</u>	<u>Cost</u>
Fixed income mutual funds	\$ 3,849,923	\$ 3,905,086
Domestic equity mutual funds	4,044,808	2,843,835
International equity mutual funds	3,958,497	3,313,940
Commodity mutual funds and other	1,299,947	1,189,929
U.S. government and agency securities	27,520	22,619
	<u>\$ 13,180,695</u>	<u>\$ 11,275,409</u>

  

	<u>December 31, 2016</u>	
	<u>Fair Value</u>	<u>Cost</u>
Fixed income mutual funds	\$ 3,807,015	\$ 3,977,970
Domestic equity mutual funds	3,601,977	2,651,127
International equity mutual funds	3,374,526	3,476,969
Commodity mutual funds and other	1,436,426	1,305,135
U.S. government and agency securities	25,656	22,619
	<u>\$ 12,245,600</u>	<u>\$ 11,433,820</u>

The following summarizes the investment return for the periods ending and its classification in the Statement of Activities:

	<u>June 30,</u> <u>2017</u>	<u>December 31,</u> <u>2016</u>
Interest and dividends	\$ 173,711	\$ 433,028
Net realized losses	18,671	(41,956)
Net unrealized gains	780,049	952,378
Fees - money manager	(169)	(1,663)
Total investment return	<u>\$ 972,262</u>	<u>\$ 1,341,787</u>

**ORTHOPAEDIC RESEARCH AND EDUCATION FOUNDATION**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2017 and December 31, 2016**

**Note 2 – Marketable Securities and Investment Return (cont.)**

	June 30, 2017	December 31, 2016
Statement of Activities		
Investment return from operations	\$ 193,769	\$ 388,517
Investment return on endowment	778,493	953,270
Total investment return	<u>\$ 972,262</u>	<u>\$ 1,341,787</u>

**Note 3 – Fair Value Measurements**

GAAP define fair value as the price that would be received for an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants on the measurement date. These standards also establish 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 standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Valuation derived from valuation techniques, in which one or more significant inputs are unobservable.

In determining the appropriate levels, the Foundation performs a detailed analysis of the assets and liabilities that are subject to ASC Topic, Fair Value Measurements and Disclosures.

The Foundation assesses the levels of investments at each measurement date, and transfers between levels are recognized on the actual date of the event of change in circumstances that caused the transfer in accordance with the Foundation's accounting policy regarding the recognition of transfers between levels of the fair value hierarchy. For the periods ended June 30, 2017 and December 31, 2016, there were no such transfers.

The following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used for the periods ended June 30, 2017 and December 31, 2016:

**ORTHOPAEDIC RESEARCH AND EDUCATION FOUNDATION**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2017 and December 31, 2016**

**Note 3 – Fair Value Measurements (cont.)**

*Marketable Securities:*

The Foundation's marketable securities include government bonds and various stocks and mutual funds. Government bonds and stocks are traded on a national securities exchange and are stated at the last reported sales price on the date of valuation. Investments in mutual funds are stated at their reported net asset value as of the valuation date. The investments are entirely Level 1 assets as defined by ASC Topic, Fair Value Measurements and Disclosures, at June 30, 2017 and December 31, 2016.

*Charitable Remainder Trusts:*

Fair value of the assets held in charitable remainder trusts is determined by calculating the present value of the future expected cash flows. Future cash flows are estimated based on the lesser of the total assets of the trust or the amount pledged to the Foundation, and management's estimate of the year of receipt. Discount rates used are based on the U.S. Treasury rate plus a risk premium. Discount rates used for the periods ended June 30, 2017 and December 31, 2016, range from 2.75 percent to 3.29 percent. The charitable remainder trusts are categorized as Level 3 in the fair value hierarchy at June 30, 2017 and December 31, 2016.

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 Foundation believes that the 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 fair value measurement at the reporting date.

Assets Measured on a Recurring Basis

Assets measured at fair value on a recurring basis are summarized below:

	Fair Value	Fair Value Measurements at June 30,2017		
		Level 1	Level 2	Level 3
Fixed income mutual funds	\$ 3,849,923	\$ 3,849,923	\$ -	\$ -
Domestic equity mutual funds	4,044,808	4,044,808	-	-
International equity mutual funds	3,958,497	3,958,497	-	-
Commodity mutual funds and other	1,299,947	1,299,947	-	-
US government and agency securities	27,520	27,520	-	-
Charitable remainder trusts	2,765,159	-	-	2,765,159
	<u>\$ 15,945,854</u>	<u>\$ 13,180,695</u>	<u>\$ -</u>	<u>\$ 2,765,159</u>

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**Note 3 – Fair Value Measurements (cont.)**

	Fair Value	Fair Value Measurements at December 31,2016		
		Level 1	Level 2	Level 3
Fixed income mutual funds	\$ 3,807,015	\$ 3,807,015	\$ -	\$ -
Domestic equity mutual funds	3,601,977	3,601,977	-	-
International equity mutual funds	3,374,526	3,374,526	-	-
Commodity mutual funds and other	1,436,426	1,436,426	-	-
US government and agency securities	25,656	25,656	-	-
Charitable remainder trusts (restated)	2,726,475	-	-	2,726,475
	<u>\$ 14,972,075</u>	<u>\$ 12,245,600</u>	<u>\$ -</u>	<u>\$ 2,726,475</u>

Fair value measurements using significant unobservable inputs (Level 3):

	Charitable Remainder Trusts
Balance January 1, 2016 (restated)	\$ 2,816,678
Change in value, net of discount	(90,203)
Balance December 31, 2016 (restated)	<u>2,726,475</u>
Change in value, net of discount	38,684
Balance, June 30,2017	<u>\$ 2,765,159</u>

**Note 4 – Charitable Remainder Trusts**

The Foundation is named as a beneficiary of various irrevocable charitable remainder trusts. A charitable remainder trust provides for the payment of distributions to the grantor or other designated beneficiaries over the trust's term (usually the designated beneficiary's lifetime). At the end of the trust's term, a specified portion of the remaining assets are available for the Foundation's use or for investment in the perpetuity. The fair value of the trust attributable to the present value of the future benefits to be received by the Foundation is recorded in the statement of activities as temporarily restricted or permanently restricted contributions in the period the trust was established and in the statement of financial position as a charitable remainder trust receivable. The estimated present value of the charitable remainder trusts totaled \$2,765,159 and \$2,726,475 at June 30, 2017 and December 31, 2016 (restated), respectively.

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**Note 4 – Charitable Remainder Trusts (cont.)**

The Foundation has not been designated as the trustee of any of the trusts and therefore does not hold any of the trust assets, nor is it liable for payment of distributions to the donors. The present value of the estimated future payments was calculated using a discount rate based on the U.S. Treasury yield rate plus a 0.5 percent risk premium for maturities that correspond to the discount period. The discount period is based on the designated beneficiary's expected life based on the applicable mortality tables.

In addition, a donor challenged two orthopaedic partner organizations to raise \$250,000 each for the Foundation by the end of 1998, at which time the donor would match each contribution up to \$250,000. Each challenge was met, and the donor has stipulated that the Foundation will receive \$500,000 from his charitable remainder trust, which is a revocable trust. The matching funds will not be recorded until the contribution becomes irrevocable.

**Note 5 – Pledges Receivable**

Pledges receivable as of June 30, 2017 and December 31, 2016, represent unconditional promises to give and are due as follows:

	June 30, 2017	December 31, 2016
Less than one year	\$ 554,369	\$ 1,292,799
One to five years	1,788,188	1,662,013
Five to ten years	66,001	65,601
Ten to fifteen years	25,000	25,000
Fifteen to twenty years	1,000	1,000
	<u>2,434,558</u>	<u>3,046,413</u>
Less: discount to net present value	(1,709)	(3,938)
Less: allowance for uncollectible pledges	(200,000)	(200,000)
Net pledge receivable	<u>2,232,849</u>	<u>2,842,475</u>
Less: Current portion	<u>(2,150,024)</u>	<u>(2,762,330)</u>
Noncurrent pledges receivable, net	<u>\$ 82,825</u>	<u>\$ 80,145</u>

The discount rate used in determining the net present value of pledges receivable was 2.8% and 3.75% at June 30, 2017 and December 31, 2016, respectively.

For the six months ended June 30, 2017, contributions of \$71,400, including pledges of \$70,000, were received from Board members. Pledges from Board members totaling \$147,000 were outstanding at June 30, 2017.

For the twelve months ended December 31, 2016, contributions of \$144,739, including pledges of \$81,538, were received from Board members. Pledges from Board members totaling \$30,000 were outstanding at December 31, 2016.

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**Note 6 – Life Insurance Policies**

In 1995, the Foundation began a fundraising program encouraging donors to make charitable gifts in the form of life insurance policies. Donors make charitable, tax-deductible contributions to the Foundation annually in the amount of the insurance premiums. The Foundation purchases the life insurance policies on these donors and is the owner and beneficiary of the policies. The cash surrender value of the policies was \$2,231,684 and \$2,156,437 at June 30, 2017 and December 31, 2016, respectively.

**Note 7 – Property and Equipment**

Property and equipment at June 30, 2017 and December 31, 2016, consists of:

	June 30, 2017	December 31, 2016
Office furniture and equipment	\$ 68,307	\$ 68,307
Computer equipment	120,274	114,901
Computer software	51,219	89,070
Leasehold improvements	50,447	50,447
	<u>290,247</u>	<u>322,725</u>
Less: accumulated depreciation and amortization	(159,060)	(151,329)
	<u>\$ 131,187</u>	<u>\$ 171,396</u>

**Note 8 – Grants and Awards Payable**

	June 30, 2017	December 31, 2016
Grants and awards payable	\$ 2,734,813	\$ 2,835,191
Discount to net present value	(43,776)	(27,205)
	<u>2,691,037</u>	<u>2,807,986</u>
Current portion	(1,916,426)	(2,172,626)
Noncurrent grants and awards payable	<u>\$ 774,611</u>	<u>\$ 635,360</u>

The discount rate used in determining the net present value of grants and awards payable was 4.25% and 3.75% percent at June 30, 2017 and December 31, 2016, respectively.

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**Note 9 – Temporarily Restricted Net Assets**

Temporarily restricted net assets are available for the following purposes or periods at June 30, 2017:

	June 30, 2017	December 31, 2016 (restated)
Spine Study Group Program	\$ 743,540	\$ 743,540
Research grants (restated)	5,679,814	5,801,399
Future Periods (restated)	352,038	332,404
	<u>\$ 6,775,392</u>	<u>\$ 6,877,343</u>

**Note 10 – Permanently Restricted Net Assets**

At June 30, 2017 and December 31, 2016, the income from permanently restricted net assets is expendable to support the following:

	June 30, 2017	December 31, 2016 (restated)
Orthopaedic partner grants and awards	\$ 114,416	\$ 143,862
Foundation grants and awards (restated)	16,207,268	16,153,946
	<u>\$ 16,321,684</u>	<u>\$ 16,297,808</u>

The Foundation has signed agreements with 27 Orthopaedic Partner Organizations (Partners) to release to the Partners the permanently restricted net assets the Foundation had previously received. The Partners have agreed to consider the released funds to be permanently restricted and to use the investment earnings for a purpose consistent with the charitable purpose of the Partners. The total amount distributed during the periods ending June 30, 2017 and December 31, 2016 was \$70,089 and \$5,132,563, respectively.

**Note 11 – Retirement Plan**

The Foundation transitioned from a defined contribution retirement plan to a qualified 401(k) retirement plan in 2016. All employees previously vested in the defined contribution retirement plan were fully transitioned into the qualified 401(k) retirement plan (the plan). Employees are eligible after completing 30 days of continuous employment as defined in the plan document. Upon entrance into the plan, employees are fully vested. Eligible employees can contribute up to 15% of their monthly salary into the plan. The Foundation makes a non-discretionary matching contribution for the employees up to 4% and a safe harbor contribution of deferred compensation. The plan may be amended or terminated at any time. Retirement plan expense was \$47,684 and \$92,871 for the periods ending June 30, 2017 and December 31, 2016, respectively.

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**Note 12 – Commitments**

The Foundation leases its existing office space at \$10,338 per month, with the Ortho Properties LLC, through December 2024.

The future minimum rental commitments under these leases through June 30, 2024 are as follows:

<u>June 30:</u>	<u>Amount</u>
2018	\$ 139,777
2019	145,368
2020	151,183
2021	157,230
2022	163,520
2023 - 2024	428,746
	<u><u>\$ 1,185,824</u></u>

Total expense under the above lease was \$63,521 and \$132,334 for the periods ending June 30, 2017 and December 31, 2016, respectively.

**Note 13 – Endowment**

The Foundation's endowment consists of over 40 donor-restricted funds established for programs of the Foundation and its orthopaedic partners. As required by accounting standards generally accepted in the United States, net assets associated with endowment funds, including funds designated by the Board of Trustees to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

The Foundation's Board of Trustees has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of the purchasing power (real value) of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Foundation classifies as permanently restricted net assets (1) the original value of gifts donated to the permanent endowment, (2) the original value of subsequent gifts to the permanent endowment, and (3) 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 Foundation has adopted investment and spending policies for the endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. The Foundation's spending and investment policies work together to achieve this objective. The investment policy established an achievable return objective through diversification of asset classes. The current long-term investment return objective is to provide a nominal return of 8 percent or greater, net of investment fees. Actual returns in any given year may vary from this amount.

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**Note 13 – Endowment (cont.)**

To satisfy its long-term rate-of-return objectives, the Foundation 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 Foundation targets a diversified asset allocation that places greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk parameters.

The Foundation's endowment spending policy determines the distribution of the investment earnings of these funds absent any donor specifications to the contrary. This spending policy calculated the amount annually distributed from the Foundation's various endowment funds for the grant making and administration. Under the current endowment spending policy, 5 percent of the average of the fair value of donor-restricted marketable securities at the end of the previous 12 quarters is appropriated to support current operations, representing an appropriation of current year total investment return.

	June 30, 2017			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ (2,731,814)	\$ -	\$ 10,746,149	\$ 8,014,335
	December 31, 2016 (restated)			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds (restated)	\$ (3,510,307)	\$ -	\$ 10,816,570	\$ 7,306,263

Endowment net asset composition by type of funds as of June 30, 2017 and December 31, 2016:

	June 30, 2017			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$ (3,510,307)	\$ -	\$ 10,816,570	\$ 7,306,263
Contributions	-	-	10,723	10,723
Investment income	778,493	-	-	778,493
Transfers to orthopaedic partners	-	-	(81,144)	(81,144)
Amounts appropriated for expenditure	-	-	-	-
Endowment net assets, end of year	\$ (2,731,814)	\$ -	\$ 10,746,149	\$ 8,014,335

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**Note 13 – Endowment (cont.)**

	December 31, 2016 (restated)			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Endowment net assets, beginning of year	\$ (4,463,577)	\$ -	\$ 17,270,336	\$ 12,806,759
Contributions	-	-	48,562	48,562
Investment income	953,270	-	-	953,270
Transfers to orthopaedic partners	-	-	(6,230,393)	(6,230,393)
Amounts appropriated for expenditure	-	-	(271,935)	(271,935)
Endowment net assets, end of year	<u>\$ (3,510,307)</u>	<u>\$ -</u>	<u>\$ 10,816,570</u>	<u>\$ 7,306,263</u>

In recent years, the endowment suffered losses in excess of \$8.8 million which were classified in the unrestricted net asset category. Therefore, when applicable, endowment earnings are classified as unrestricted in order to replenish the unrestricted fund. The unrestricted endowment deficit is \$2,731,814 and \$3,510,307 at June 30, 2017 and December 31, 2016, respectively.

Reconciliation between endowment fund and permanently restricted net assets as of June 30, 2017 and December 31, 2016 is as follows:

	2017	2016 (restated)
Total endowment net assets	\$ 10,746,149	\$ 10,816,570
Charitable remainder trust	1,863,929	1,844,879
Cash surrender value of life insurance	1,526,032	1,450,785
Other non-endowment funds	2,185,574	2,185,574
Total permanently restricted net assets	<u>\$ 16,321,684</u>	<u>\$ 16,297,808</u>

**Note 14 – Prior Period Adjustments**

During the years ended December 31, 2016 and 2015, the Organization used outdated life expectancy rates to estimate discounts for the charitable remainder trusts. At December 31, 2016 and 2015, the net assets were reduced by \$70,981 and \$317,823, respectively, and the charitable remainder trust receivable discount was adjusted by the same amount.