

**ORTHOPAEDIC RESEARCH AND
EDUCATION FOUNDATION**

FINANCIAL STATEMENTS

**For the Year Ended
June 30, 2019**

**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, 2019, and the related statements of activities, functional expenses, and cash flows for the year 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, 2019 and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Summarized Comparative Information

We have previously audited Orthopaedic Research and Education Foundation's June 30, 2018 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated December 12, 2018. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2018, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Emphasis of Matter

As discussed in Note 1 to the financial statements, Orthopaedic Research and Education Foundation adopted the Financial Accounting Standards Board's Accounting Standards update ("ASU") 2016-14, *Not-for-Profit Entities (Topic 958) – Presentation of Financial Statements of Not-for-Profit Entities* as of and for the year ended June 30, 2019. The requirements of the ASU have been applied retrospectively to all periods presented. Our opinion is not modified with respect to this matter.

Desmond & Ahern, Ltd

March 27, 2020
Chicago, IL

ORTHOPAEDIC RESEARCH AND EDUCATION FOUNDATION
STATEMENT OF FINANCIAL POSITION
June 30, 2019 (with comparative totals for 2018)

	<u>2019</u>	<u>2018</u>
<u>Assets</u>		
Current Assets		
Cash and cash equivalents	\$ 3,529,222	\$ 1,544,114
Investments	13,069,749	14,772,453
Pledges receivable, net	679,019	1,776,836
Other receivables	14,084	18,791
Prepaid expenses	31,654	52,573
Total current assets	<u>17,323,728</u>	<u>18,164,767</u>
Other Assets		
Certificates of deposit	-	1,200,000
Pledge receivable - long-term	1,297,527	1,280,103
Cash surrender value of life insurance policies	1,759,748	1,708,744
Charitable remainder trusts receivable	2,821,579	2,571,120
Property and equipment, net	79,004	106,947
Restricted cash	436,801	506,074
Total other assets	<u>6,394,659</u>	<u>7,372,988</u>
Total Assets	<u>\$ 23,718,387</u>	<u>\$ 25,537,755</u>
<u>Liabilities and Net Assets</u>		
Current Liabilities		
Grants and awards payable - current	\$ 2,306,947	\$ 1,767,975
Accounts payable	29,955	36,876
Accrued expenses	155,289	164,671
Due to orthopaedic partners	620,971	699,042
Total current liabilities	<u>3,113,162</u>	<u>2,668,564</u>
Grants and awards payable - long-term	<u>861,172</u>	<u>1,366,112</u>
Total liabilities	<u>3,974,334</u>	<u>4,034,676</u>
Net Assets		
Without donor restrictions (restated)	453,327	418,258
With donor restrictions:		
Purpose restrictions (restated)	3,887,518	4,804,332
Endowment (restated)	15,403,208	16,280,489
Total net assets	<u>19,744,053</u>	<u>21,503,079</u>
Total Liabilities and Net Assets	<u>\$ 23,718,387</u>	<u>\$ 25,537,755</u>

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

ORTHOPAEDIC RESEARCH AND EDUCATION FOUNDATION
STATEMENT OF ACTIVITIES
For the Year Ended June 30, 2019 (with comparative totals for 2018)

	2019			2018 Total	
	Without Donor Restrictions	Purpose Restrictions	Endowment		Total
Public Support and Revenue					
Contributions	\$ 1,384,229	\$ 1,778,251	\$ 25,806	\$ 3,188,286	\$ 5,432,567
Contributions to endowments	-	-	9,725	9,725	15,626
Change in value of charitable remainder trusts receivable	-	120,160	130,298	250,458	(194,039)
Change in cash surrender value of life insurance policies	-	-	59,802	59,802	593
Investment return, net of fees	64,887	-	-	64,887	639,780
Net assets released from restrictions					
Expiration of time restrictions and other releases	1,367,146	(1,367,146)	-	-	-
Grant funding	2,165,408	(2,165,408)	-	-	-
Total public support and revenue	4,981,670	(1,634,143)	225,631	3,573,158	5,894,527
Expenses					
Program Expenses	3,087,365	-	-	3,087,365	3,288,934
Management and general	971,830	-	-	971,830	1,054,678
Fundraising	887,406	-	-	887,406	843,889
Total expenses	4,946,601	-	-	4,946,601	5,187,501
Change in net assets before non-operating items	35,069	(1,634,143)	225,631	(1,373,443)	707,026
Non-Operating Items:					
Investment gain on endowment assets	-	733,712	-	733,712	250,683
Orthopaedic partner endowment distributions	-	(16,383)	(1,102,912)	(1,119,295)	(45,784)
	-	717,329	(1,102,912)	(385,583)	204,899
Change in Net Assets	35,069	(916,814)	(877,281)	(1,759,026)	911,925
Net assets, beginning of year	418,258	4,804,332	16,280,489	21,503,079	20,591,154
Net assets, end of year	\$ 453,327	\$ 3,887,518	\$ 15,403,208	\$ 19,744,053	\$ 21,503,079

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

**ORTHOPAEDIC RESEARCH AND EDUCATION FOUNDATION
STATEMENTS OF FUNCTIONAL EXPENSES**

For the Year Ended June 30, 2019 (with comparative totals for 2018)

	Program Services	Management and General	Fundraising	2019 Total	2018 Total
<u>Functional Expenses</u>					
Salaries	\$ 394,358	\$ 578,392	\$ 398,931	\$ 1,371,681	\$ 1,288,275
Payroll taxes and fringe benefits	72,625	110,118	73,467	256,210	287,231
Grants	2,231,583	-	-	2,231,583	2,582,644
Professional services	19,948	40,041	35,724	95,713	173,165
Advertising and promotion	30,780	20,746	117,640	169,166	134,663
Office expenses	14,845	36,488	32,633	83,966	68,567
Information technology	32,629	47,856	33,008	113,493	106,032
Occupancy	30,057	58,839	39,179	128,075	127,903
Travel	2,560	26,694	18,322	47,576	50,016
Conferences and meetings	124,469	14,596	54,506	193,571	125,640
Depreciation	6,427	12,854	8,662	27,943	41,012
Insurance	58,834	24,015	4,266	87,115	93,089
Bad debt	68,250	-	68,250	136,500	68,387
Dues and subscriptions	-	1,149	2,818	3,967	5,298
Recognition awards	-	-	-	-	5,273
Miscellaneous	-	42	-	42	19,459
Total Expenses	\$ 3,087,365	\$ 971,830	\$ 887,406	\$ 4,946,601	\$ 5,176,654

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

ORTHOPAEDIC RESEARCH AND EDUCATION FOUNDATION
STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2019 (with comparative totals for 2018)

	<u>2019</u>	<u>2018</u>
<u>Cash Flows from Operating Activities</u>		
Change in net assets	\$ (1,759,026)	\$ 911,925
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	27,943	41,012
Net unrealized gains on investments	(324,528)	(250,930)
Net realized gains on investments	(32,869)	(133,515)
Change in cash surrender value of life insurance policies	(51,004)	522,940
Change in charitable remainder trusts receivable	(250,459)	194,039
Bad debt expense	136,500	68,387
Distributions of orthopaedic partner endowments	62,963	148,450
(Distributions) proceeds from permanently restricted contributions	877,281	41,195
Decrease (increase) in		
Pledges receivable	943,893	(892,477)
Other receivables	4,707	(1,911)
Prepaid expenses	20,919	(12,665)
Increase (decrease) in		
Grants and awards payable	34,032	443,049
Accounts payable	(6,921)	(23,167)
Accrued expenses	(9,382)	48,337
Due to orthopaedic partners	(78,071)	(575,250)
Net cash provided by (used in) operating activities	<u>(404,022)</u>	<u>529,419</u>
<u>Cash Flows from Investing Activities</u>		
Proceeds from sales of marketable securities	5,771,407	3,698,661
Purchases of marketable securities	(3,711,306)	(4,905,974)
Sales and maturities of certificates of deposit	1,200,000	398,166
Purchases of property and equipment	-	(16,772)
Net cash provided by (used in) investing activities	<u>\$ 3,260,101</u>	<u>\$ (825,919)</u>

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

ORTHOPAEDIC RESEARCH AND EDUCATION FOUNDATION
STATEMENT OF CASH FLOWS (CONT.)
For the Year Ended June 30, 2019 (with comparative totals for 2018)

	<u>2019</u>	<u>2018</u>
<u>Cash Flows from Financing Activities</u>		
Distributions of orthopaedic partner endowment	\$ (62,963)	\$ (148,450)
Proceeds (distributions) from permanently restricted contributions	<u>(877,281)</u>	<u>(41,195)</u>
Net cash provided by (used in) investing activities	<u>(940,244)</u>	<u>(189,645)</u>
Net increase (decrease) in cash and cash equivalents	1,915,835	(486,145)
Cash and cash equivalents, beginning of year	<u>2,050,188</u>	<u>2,536,333</u>
Cash and cash equivalents, end of year	<u><u>\$ 3,966,023</u></u>	<u><u>\$ 2,050,188</u></u>
Consists of:		
Cash and equivalents (current)	\$ 3,529,222	\$ 1,544,114
Restricted cash	<u>436,801</u>	<u>506,074</u>
Total cash and cash equivalents	<u><u>\$ 3,966,023</u></u>	<u><u>\$ 2,050,188</u></u>

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

ORTHOPAEDIC RESEARCH AND EDUCATION FOUNDATION
NOTES TO FINANCIAL STATEMENTS
June 30, 2019

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 is required to report information regarding its financial position and activities based on the existence or absence of donor-imposed restrictions, as required by Generally Accepted Accounting Principles. Accordingly, net assets and changes therein are classified and reported as follows:

Without Donor Restrictions – Net assets available for use in general operations and not subject to donor (or certain grantor) restrictions. Items that affect this net asset category principally consist of gifts without restrictions, including those designated by the Board, fees for service and related expenses associated with the core activities of the Foundation.

ORTHOPAEDIC RESEARCH AND EDUCATION FOUNDATION
NOTES TO FINANCIAL STATEMENTS
June 30, 2019

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

With Donor Restrictions – Net assets subject to donor-imposed restrictions that will be met either by actions of the Foundation or the passage of time. Items that affect this net asset category are gifts for which donor-imposed restrictions have not been met, endowment gifts, pledges, and investment returns on endowment funds. Expirations of restrictions on net assets with donor restrictions, including reclassification of restricted gifts and grants for buildings and equipment when the associated long-lived asset is placed in service, are reported as net assets released from restrictions.

Also included in this category are net assets subject to donor-imposed restrictions to be maintained permanently by the Foundation, including gifts and pledges wherein donors stipulate that the corpus of the gift be held in perpetuity and that only the income be made available for program operations.

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.

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. No cash was paid for interest or taxes during the year ended June 30, 2019.

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.

Investments

Investments, 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

ORTHOPAEDIC RESEARCH AND EDUCATION FOUNDATION
NOTES TO FINANCIAL STATEMENTS
June 30, 2019

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

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

Certificates of deposit are fully insured by the FDIC and are carried at their original cost plus accrued interest.

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.

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.

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 \$535,721 during the year ended June 30, 2019. A total of \$620,971 has not been remitted to these orthopaedic partners and is included on the statement of financial position as of June 30, 2019.

ORTHOPAEDIC RESEARCH AND EDUCATION FOUNDATION
NOTES TO FINANCIAL STATEMENTS
June 30, 2019

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

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.

Property and Equipment

Property and equipment purchases of \$2,000 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.

Functional Allocation of Expenses

The costs of providing various programs and other activities have been summarized on a functional basis in the Statement of Activities and the Statement of Functional Expenses. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Directly identifiable expenses are charged to the specific program or supporting service. Expenses related to more than one function are allocated to program expenses and supporting services as the basis of periodic time and expense reviews made 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, 2019.

ORTHOPAEDIC RESEARCH AND EDUCATION FOUNDATION
NOTES TO FINANCIAL STATEMENTS
June 30, 2019

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

Comparative Information

The financial statements include certain prior-year summarized comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with generally accepted accounting principles. Accordingly, such information should be read in conjunction with the Foundation’s audited financial statements for the year ended June 30, 2018, from which the summarized information was derived.

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 March 27, 2020, 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.

Not-for-Profit Financial Statement Presentation

During fiscal 2019, the Foundation adopted Accounting Standards Update (“ASU”) No. 2016-14 – *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. This guidance is intended to improve the net asset classification requirements and the information presented in the financial statements and notes about a not-for-profit entity’s liquidity, financial performance, and cash flows.

Main provisions of this guidance include: presentation of two classes of net assets versus the previously required three; recognition of capital gifts for construction of a net asset without donor restrictions where the associated long-lived asset is placed in service; and recognition of underwater endowment funds as a reduction in net assets with donor restrictions. The guidance also enhances disclosures for board designated amounts, composition of net assets without donor restrictions, liquidity, and expenses by both their natural and functional classification.

Reclassification of net assets were necessary by the adoption of ASU No. 2016-14 by OREF as of June 30, 2019. The underwater portion of endowments is now considered with donor restrictions. Net assets with donor restrictions decreased by \$2,481,131 at June 30, 2018.

Contingency

The Organization’s operations could be significantly impacted by the novel coronavirus pandemic after the Organization fiscal year end of June 30, 2019. Management is maintaining operations to the extent possible however some operations will be affected. The value of several of the Organization’s assets could be affected by this crisis. It is not possible to reasonably estimate the effect of this Crisis on the Organization or whether would be material to the Organization's financial statements at June 30, 2019.

ORTHOPAEDIC RESEARCH AND EDUCATION FOUNDATION
NOTES TO FINANCIAL STATEMENTS
June 30, 2019

Note 2 – Financial Assets and Liquidity Resources

As of June 30, 2019, financial assets and liquidity resources available within one year for general expenditure, such as operating expenses, were as follows:

Financial assets, at year-end:	
Cash and cash equivalents	\$ 3,529,222
Investments	13,069,749
Pledges receivable	879,019
Total financial assets, at year-end	<u>17,477,990</u>
Less:	
Net assets with donor restrictions - Purpose	(3,887,518)
Net assets with donor restrictions - Endowment, net of endowment assets held in non-current accounts	(10,385,080)
Allowance for doubtful pledges	<u>(200,000)</u>
Financial assets available to meet cash need for general expenditures within one year	<u><u>\$ 3,005,392</u></u>

The Foundation manages its liquidity and reserves following three guiding principles: 1) operating within a prudent range of financial soundness and stability; 2) maintaining adequate liquid assets to fund near-term operating needs; and 3) maintaining sufficient reserves to provide reasonable assurance that programming is continued, and obligations will be adequately discharged in the future. During the year ended June 30, 2019 the level of liquidity and reserves was managed within the policy requirements.

Note 3 – Investments and Investment Return

At June 30, 2019, the aggregate amounts of investments by major type recorded at fair value were as follows:

	<u>Fair Value</u>	<u>Cost</u>
Fixed income mutual funds	\$ 4,538,178	\$ 4,468,089
Domestic equity mutual funds	3,867,380	2,640,199
International equity mutual funds	3,884,241	3,542,829
Commodity mutual funds and other	748,387	653,255
U.S. government and agency securities	31,563	22,619
	<u>\$ 13,069,749</u>	<u>\$ 11,326,991</u>

ORTHOPAEDIC RESEARCH AND EDUCATION FOUNDATION
NOTES TO FINANCIAL STATEMENTS
June 30, 2019

Note 3 – Investments and Investment Return (cont.)

The following summarizes the investment return for the year ending June 30, 2019 and its classification in the Statement of Activities:

Interest and dividends	\$ 441,988
Net realized gains	32,869
Net unrealized gains	324,528
Brokerage fees	(786)
Total investment return	\$ 798,599
Statement of Activities	
Investment return from operations	\$ 64,887
Investment return on endowment	733,712
Total investment return	\$ 798,599

Note 4 – 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 period ended June 30, 2019, there were no such transfers.

ORTHOPAEDIC RESEARCH AND EDUCATION FOUNDATION
NOTES TO FINANCIAL STATEMENTS
June 30, 2019

Note 4 – Fair Value Measurements (cont.)

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 period ended June 30, 2019.

Investments

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, 2019.

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, 2019, range from 3.03 percent to 3.58 percent. The charitable remainder trusts are categorized as Level 3 in the fair value hierarchy at June 30, 2019.

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	Level 1	Level 2	Level 3
Fixed income mutual funds	\$ 4,538,178	\$ 4,538,178	\$ -	\$ -
Domestic equity mutual funds	3,867,380	3,867,380	-	-
International equity mutual funds	3,884,241	3,884,241	-	-
Commodity mutual funds and other	748,387	748,387	-	-
US government and agency securities	31,563	31,563	-	-
Charitable remainder trusts	2,821,579	-	-	2,821,579
	<u>\$15,891,328</u>	<u>\$13,069,749</u>	<u>\$ -</u>	<u>\$ 2,821,579</u>

ORTHOPAEDIC RESEARCH AND EDUCATION FOUNDATION
NOTES TO FINANCIAL STATEMENTS
June 30, 2019

Note 4 – Fair Value Measurements (cont.)

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

	Charitable Remainder Trusts
Balance June 30, 2018	\$ 2,571,120
Change in value, net of appreciation	250,459
Balance, June 30, 2019	<u>\$ 2,821,579</u>

Note 5 – 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 \$2,821,579 at June 30, 2019.

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 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 \$1,759,748 and at June 30, 2019.

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Note 7 – Pledges Receivable

Pledges receivable as of June 30, 2019, represent unconditional promises to give and are due as follows:

Less than one year, including allowance of \$200,000	\$ 679,019
One to five years	1,296,792
Five to ten years	308,000
Ten to fifteen years	3,000
	<u>2,286,811</u>
Less: discount to net present value	(310,265)
Net pledge receivable	<u>1,976,546</u>
Less: Current portion	(679,019)
Noncurrent pledges receivable, net	<u><u>\$ 1,297,527</u></u>

The discount rate used in determining the net present value of pledges receivable was 5.5% at June 30, 2019.

For the year ended June 30, 2019, contributions of \$53,602, were received from Board members. Pledges receivable from Board members totaling \$40,000 were outstanding at June 30, 2019.

Note 8 – Property and Equipment

Property and equipment at June 30, 2019, consists of:

Office furniture and equipment	\$ 53,843
Computer equipment	76,853
Computer software	64,025
Leasehold improvements	50,447
	<u>245,168</u>
Less: accumulated depreciation and amortization	(166,164)
	<u><u>\$ 79,004</u></u>

Note 9 – Grants and Awards Payable

Grants and awards payable	\$ 3,229,473
Discount to net present value	(61,354)
	<u>3,168,119</u>
Current portion	(2,306,947)
Noncurrent grants and awards payable	<u><u>\$ 861,172</u></u>

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June 30, 2019

Note 9 – Grants and Awards Payable (cont.)

The discount rate used in determining the net present value of grants and awards payable was 5.5% at June 30, 2019.

Note 10 – Net Assets With Donor Restrictions (Purpose and Time)

Net assets with donor restrictions are available for the following purposes or periods at June 30, 2019:

Research grants	\$ 5,284,584
Underwater endowment	(1,763,802)
Future Periods	<u>366,736</u>
	<u>\$ 3,887,518</u>

Note 11 – Net Assets With Donor Restrictions (Endowments)

At June 30, 2019, the income from net assets with donor restrictions (endowments) is expendable to support the following:

Orthopaedic partner endowments	\$ 114,416
Foundation grants and awards	<u>15,288,792</u>
	<u>\$ 15,403,208</u>

The Foundation has signed agreements with 27 Orthopaedic Partner Organizations (Partners) to release to the Partners the net assets with donor restrictions (endowments) 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 year ended June 30, 2019 was \$1,119,295.

Note 12 – 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 \$82,488 for the year ended June 30, 2019.

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Note 13 – Commitments

The Foundation leases its existing office space at \$10,751 per month, with the Ortho Properties LLC, through December 2024.

The future minimum rental commitments under these leases through June 30, 2025 are as follows:

<u>June 30:</u>	<u>Amount</u>
2020	\$ 125,680
2021	130,707
2022	135,936
2023	141,373
2024	147,028
Thereafter	68,020
	<u>\$ 748,744</u>

Total expense under the above lease was \$127,042 for the year ended June 30, 2019.

Note 14 – 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.

ORTHOPAEDIC RESEARCH AND EDUCATION FOUNDATION
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Note 14 – 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, 2019		
	With Donor Restrictions Purpose	With Donor Restrictions Endowment	Total
Donor-restricted endowment funds	\$ (1,763,802)	\$ 9,725,557	\$ 7,961,755

Endowment net asset composition by type of funds as of June 30, 2019:

	June 30, 2019		
	With Donor Restrictions Purpose	With Donor Restrictions Endowment	Total
Endowment net assets, beginning of year	\$ (2,481,131)	\$ 10,792,938	\$ 8,311,807
Contributions	-	35,531	35,531
Investment income	733,712	-	733,712
Transfers to orthopaedic partners	(16,383)	(1,102,912)	(1,119,295)
Endowment net assets, end of year	\$ (1,763,802)	\$ 9,725,557	\$ 7,961,755

In recent years, the endowment suffered losses which have caused the endowment to be underwater. These losses are classified in the net assets with donor restrictions purpose category. Therefore, when applicable, endowment earnings are classified as net assets with donor restrictions purpose in order to replenish the with donor restrictions purpose fund. The net assets with donor restrictions purpose deficit is \$1,763,802 at June 30, 2019.

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Note 14 – Endowment (cont.)

Reconciliation between endowment fund and permanently restricted net assets as of June 30, 2019 is as follows:

Total endowment net assets	\$ 9,725,557
Charitable remainder trust	1,905,652
Cash surrender value of life insurance	1,575,578
Other non-endowment funds	<u>2,196,421</u>
Total permanently restricted net assets	<u>\$ 15,403,208</u>