

**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, 2017

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, 2017, and the related notes to the 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, 2017, 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 11 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 opinions 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 6, 2017, 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 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.



Tampa, Florida
October 6, 2017

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

YEAR ENDED JUNE 30, 2017

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, 2017, 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 total assets decreased \$5.6 million (5.9%) to \$87.4 million at June 30, 2017 from \$93.0 million at June 30, 2016. Total liabilities decreased \$11.0 million (26.7%) to \$30.4 million at June 30, 2017 from \$41.4 million at June 30, 2016. As a result of the above, and corresponding excess of revenues over expenses as described below, the Research Foundation's net position increased by \$5.2 million (10.0%), reaching a year-end balance of \$57.2 million.

The Research Foundation's operating revenues were \$12.2 million for a decrease of \$493 thousand (3.9%) from the prior fiscal year. Fiscal year 2017 operating expenses were \$9.6 million for a decrease of \$39 thousand (.4%) from fiscal year 2016.

Operating income for fiscal year 2017 was \$2.6 million, for a decrease of \$454 thousand (15.0%) from the prior fiscal year.

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

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, which is one indicator of the Research Foundation's current financial condition. The changes in net position that occur over time indicate improvement or deterioration in the Research Foundation's financial condition.

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MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

YEAR ENDED JUNE 30, 2017

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

	<u>2017</u>	<u>2016</u>
ASSETS		
Current assets	\$ 35,429,080	\$ 38,651,050
Restricted cash and cash equivalents	1,025,000	1,229,167
Capital assets, net	42,887,598	44,926,264
Other investments	235,606	305,171
Other non-current assets	<u>7,855,750</u>	<u>7,852,025</u>
Total Assets	<u>87,433,034</u>	<u>92,963,677</u>
DEFERRED OUTFLOWS OF RESOURCES		
Interest rate swap	<u>156,607</u>	<u>497,068</u>
LIABILITIES		
Current	11,334,107	11,221,640
Non-current	<u>19,031,607</u>	<u>30,217,068</u>
Total Liabilities	<u>30,365,714</u>	<u>41,438,708</u>
NET POSITION		
Net Investment in capital assets	23,447,598	14,600,431
Unrestricted	<u>33,776,329</u>	<u>37,421,606</u>
Total Net Position	<u>\$ 57,223,927</u>	<u>\$ 52,022,037</u>

The Research Foundation's total assets decreased \$5.6 million (5.9%) to \$87.4 million at June 30, 2017 from \$93.0 million at June 30, 2016.

Current assets were \$35.4 million at June 30, 2017, for a decrease of \$3.2 million (8.3%) from the prior fiscal year. The decrease in current assets includes an increase in cash of \$673 thousand (21.0%), a decrease in investments of \$3.9 million (11.4%), and \$38 thousand increase (3.6%) in accounts receivable and other current assets. Investment activity in fiscal year 2017 included sale of investments as a source of funds to pay-off debt (\$9.3 million) and funding seed capital loans (\$150 thousand), offset by additional investment of funds of \$2.0 million, and investment gains of \$3.5 million.

Capital assets decreased \$2.0 million (4.5%) from \$44.9 million at June 30, 2016 to \$42.9 million at June 30, 2017. The decrease resulted from depreciation charges of \$2.7 million, transferring ownership of \$30 thousand book value of research equipment to the University, offset by capital asset additions of \$698 thousand for fiscal year 2017.

Other non-current assets of \$7.9 million include seed capital notes (net of reserve) which increased \$75 thousand (21.0%), developer rights (net of amortization) which decreased \$116 thousand due to annual amortization of the rights (1.6%), interest receivable on seed capital notes which increased \$25 thousand (70.4%) and stock receivable which increased \$20 thousand (805.3%) in fiscal year 2017.

Total liabilities decreased \$11.0 million (26.7%) to \$30.4 million at June 30, 2017 from \$41.4 million at June 30, 2016. While current liabilities increased \$112 thousand (1.0%), non-current liabilities decreased \$11.2 million (37.0%).

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YEAR ENDED JUNE 30, 2017

The current liability for the due to University of South Florida payable and the liability for unearned revenue increased \$169 thousand (2.2%) and \$101 thousand (44.4%), respectively, as a result of additional custodial funds received in fiscal year 2017. Accounts payable and accrued liabilities increased \$87 thousand (6.7%), while current portion of long term debt decreased \$245 thousand (13.4%) compared to prior year balances.

Regarding the decrease in noncurrent liabilities, the Research Foundation paid off the Series 2013-D Note in the amount of \$9.5 million on July 29, 2016. As previously noted, redemption of investment funds provided the source of payment. Scheduled principal payments of \$1.6 million were also made in fiscal year 2017, and \$340 thousand decrease (68.5%) in the fair value of the interest rate swap agreements as a result of the debt payments occurred.

In addition to the debt payoff, the Research Foundation modified the Series 2013-B Note in fiscal year 2017, to include an amendment to the loan agreement, credit agreement and promissory note 2013-B. The debt was modified from a tax-exempt variable rate note with a pay fixed interest rate swap, to a taxable 10-year fixed rate note at 3.18% interest rate. The existing amortization scheduled through 2034 was not changed. The interest rate swap which expired August 1, 2016 was not replaced. The debt amendment caused a reduction in debt service costs.

Net position is reported in two major categories. The first category, net investment in capital assets provides the Research Foundation's equity in property, plant, and equipment owned by the Research Foundation and includes amounts representing restricted cash and cash equivalents and debt. The second category is unrestricted net position which is available to the Research Foundation for any lawful purpose of the Research Foundation. The combination of changes in both total assets and in total liabilities resulted in a net increase in total net position of \$5.2 million (10%). The increase in total net position includes an increase in net investment in capital assets of \$8.8 million (60.6%), and a decrease in unrestricted net position of \$3.6 million (9.7%).

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

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

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

	<u>2017</u>	<u>2016</u>
Operating revenues	\$ 12,203,215	\$ 12,696,158
Operating expenses	<u>9,633,109</u>	<u>9,672,191</u>
Operating income	2,570,106	3,023,967
Net non-operating revenues (expenses)	<u>2,631,784</u>	<u>(2,704,240)</u>
Increase in net position	5,201,890	319,727
Net position, beginning of year	<u>52,022,037</u>	<u>51,702,310</u>
Net position, end of year	<u><u>\$ 57,223,927</u></u>	<u><u>\$ 52,022,037</u></u>

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MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

YEAR ENDED JUNE 30, 2017

Operating Revenues

GASB Statement No. 35 categorizes revenues as either operating or non-operating. Operating revenues generally result from exchange transactions where each of the parties to the transaction either give up or receive something of equal or similar value.

Operating revenues by source used to fund operating activities during the fiscal years ended June 30, 2017 and 2016, were as follows:

	<u>2017</u>	<u>2016</u>	<u>Increase (Decrease)</u>	<u>% Change</u>
Property rental revenues	\$ 7,151,463	\$ 7,534,055	\$ (382,592)	-5.1%
Royalties, licenses and option fees	2,307,265	2,199,916	107,349	4.9%
Other license fees	307,000	307,000	-	0.0%
Incubator sponsor revenue	1,248,250	1,788,700	(540,450)	-30.2%
Incubator program revenue	516,038	511,467	4,571	0.9%
Contracts and grants	512,788	185,018	327,770	177.2%
Administrative fees	160,411	170,002	(9,591)	-5.6%
 Total Operating Revenues	 <u>\$ 12,203,215</u>	 <u>\$ 12,696,158</u>	 <u>\$ (492,943)</u>	 -3.9%

The Research Foundation's operating revenues totaled \$12.2 million for fiscal year 2017, for a decrease of \$493 thousand (3.9%) from the prior fiscal year. Fiscal year 2017 operating expenses were \$9.6 million for a decrease of \$39 thousand (.4%) from fiscal year 2016.

Property rental revenues were \$7.2 million for fiscal year 2017. Certain property leases are directly impacted by the operating expenses and debt service costs for the specific research facility being leased. Increases/ decreases to the property operating expense and debt service costs, will correspond to an increase/decrease of the operating revenue recorded from that property rental. In fiscal year 2017, property rental revenue decreased by \$484 thousand (6.4%) due to the combined effect of \$246 thousand reduced operating expenses, and \$238 thousand reduced debt service costs for two specific properties leased to the University. The decrease in property rental revenues resulting from these expense savings was offset by other increases in property rents of \$101 thousand (1.3%), for a net decrease of \$383 thousand (5.1%) from fiscal year 2016 property rental revenue.

Royalties, licenses and option fee revenue from intellectual property agreements increased \$107 thousand (4.9%) to \$2.3 million in fiscal year 2017. Royalties increased \$670 thousand (109.2%), offset by a decrease in license fees of \$567 thousand (36.6%) and a net increase in other fees of \$4 thousand. In addition to intellectual property revenue of \$2.3 million recognized by the Research Foundation in fiscal year 2017, licensees were also invoiced \$573 thousand for reimbursement of patent costs that are due the University, for a combined total of \$2.9 million in transactions. This represents an overall increase of 3.0% from fiscal year 2016. Acting as an agent for the University, the invoiced amounts for patent costs are not reflected in the Research Foundation's operating revenues.

The Incubator Program generated total revenue of \$1.8 million to include sponsor support revenue of \$1.25 million and program revenue of \$500 thousand in fiscal year 2017. Sponsor revenue to support the program decreased \$540 thousand (30.2%) from the prior fiscal year, and program revenue generated from tenant rents and fees increased by \$5 thousand (.9%). The net decrease in sponsor support of \$540 thousand resulted from additional receipts of \$700 thousand from the University occurring in fiscal year 2016 that were non-recurring in 2017. This decrease was offset by additional support in 2017 of \$100 thousand received for the program from the University, and an increase of \$60 thousand received from Hillsborough County in fiscal year 2017, due to the requisite timing

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MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

YEAR ENDED JUNE 30, 2017

as to when invoices may be submitted under terms of the current contract with the County.

The Research Foundation continues to pursue post-award management of private industry contracts and grants with the University. Operating revenue from contracts and grants which increased \$328 thousand (177.2%) to \$513 thousand in fiscal year 2017, from \$185 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 \$2.3 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.

Administrative fees of \$160 thousand were earned in fiscal year 2017 representing an overall decrease of \$10 thousand (5.6%) from \$170 thousand in fiscal year 2016. While Administrative fees for processing grants increased \$26 thousand (34.4%), this was offset by a decrease of \$21 thousand (97.8%) in fees from managing property renovation projects, and \$15 thousand decrease (19.9%) in fees received for processing Graphicstudio expenditures on behalf of the University.

Operating Expenses

Expenses are categorized as operating or non-operating. The majority of the Research Foundation's expenses are operating expenses as defined by GASB Statement No. 35. GASB gives financial reporting entities the choice of reporting operating expenses in the functional or natural classifications. The Research Foundation has chosen to report the expenses in their natural classification on the statement of revenues, expenses, and changes in net position.

The following summarizes the operating expenses for the fiscal years ended June 30, 2017 and 2016:

	<u>2017</u>	<u>2016</u>	<u>Increase (Decrease)</u>	<u>% Change</u>
<u>Property rental expenses</u>				
Research park expenses	\$ 6,106,607	\$ 6,457,247	\$ (350,640)	-5.4%
Less expense allocated to Incubator program	<u>(856,802)</u>	<u>(1,450,203)</u>	<u>593,401</u>	-40.9%
	5,249,805	5,007,044	242,761	4.8%
<u>Incubator program expenses</u>				
Rent expense	856,802	1,450,203	(593,401)	-40.9%
Other program expenses	<u>269,090</u>	<u>300,722</u>	<u>(31,632)</u>	-10.5%
	1,125,892	1,750,925	(625,033)	-35.7%
<u>Intellectual property expenses</u>				
Inventor royalties	852,503	827,584	24,919	3.0%
Inventing department and other royalties	577,338	615,609	(38,271)	-6.2%
Other intellectual property costs	<u>229,269</u>	<u>184,634</u>	<u>44,635</u>	24.2%
	1,659,110	1,627,827	31,283	1.9%
Contracts and grants	512,788	185,018	327,770	177.2%
University support	77,085	76,963	122	0.2%
Seed capital expense	75,000	102,500	(27,500)	-26.8%
Management and general	<u>933,429</u>	<u>921,914</u>	<u>11,515</u>	1.2%
Total Operating Expenses	<u>\$ 9,633,109</u>	<u>\$ 9,672,191</u>	<u>\$ (39,082)</u>	-0.4%

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

YEAR ENDED JUNE 30, 2017

Operating expenses for the Research Foundation totaled \$9.6 million for fiscal year 2017, decreasing \$39 thousand (.4%) from fiscal year 2016.

Property rental expenses were \$5.2 million in fiscal year 2017 for an increase of \$243 thousand (4.8%) from fiscal year 2016 expenses of \$5.0 million. While property rental expenses decreased \$351 thousand (5.4%), these savings were negatively offset by the reduced allocation of property expense charged to the Incubator program in 2017 for their lease of office and lab facilities within the Research Park. As a result of restructuring the incubator program's lease in fiscal year 2017, supported by reduced debt service cost for the leased property, rent expense for the incubator program decreased \$593 thousand (40.9%). These savings are reflected in incubator program expense for fiscal year 2017.

The decrease in research park expenses of \$351 thousand in 2017 was primarily attributed to reduced utilities cost of \$114 thousand (7.4%), decrease in repairs and maintenance of \$88 thousand (7.2%), reduced insurance expense of \$22 thousand (7.8%), and a decrease in depreciation expense of \$137 thousand (4.8%), less net increase in other expenses of \$10 thousand (.2%).

Operating expenses for the incubator program were \$1.1 million in fiscal year 2017, decreasing \$625 thousand (35.7%) from \$1.7 million incurred in fiscal year 2016. In addition to reduced rent expense of \$593 thousand (40.9%) for leasing office and lab facilities within the Research Park, other operating costs decreased \$32 thousand (10.5%) in fiscal year 2017. Savings in salaries and benefit expense of \$77 thousand from staff vacancies were offset by increased corporate membership expense of \$49 thousand relating to economic development and business engagement. As previously noted, the decrease in rent expense resulted from restructuring the program's lease in fiscal year 2017, supported by reduced debt service cost for the leased property.

Total intellectual property expense of \$1.7 million increased \$31 thousand (1.9%) from fiscal year 2016. Total royalty expense of \$1.4 million to inventors, University research funds and other parties decreased \$13 thousand (.9%), and as a percent to Intellectual property operating revenues, was 62% in fiscal year 2017 decreasing from 66% for fiscal year 2016.

Seed capital expense was recorded at 50% of loans funded through the seed capital accelerator program. The expense represents the estimated reserve for the net realizable value of the loans, based on the conversion features associated with the notes. In fiscal years 2017 and 2016, \$150 thousand and \$205 thousand of loans were disbursed, respectively, thereby supporting the recorded expense of \$75,000 and \$102,500.

Management and general costs were \$933 thousand in fiscal year 2017, increasing \$11 thousand (1.2%) from fiscal year 2016 expenses of \$922 thousand. The fiscal year 2017 increase is primarily attributed to increased personnel costs (wages and fringe) of \$32 thousand as a result of being fully staffed, offset by a decrease of \$10 thousand in materials and general office supplies, a decrease in accounting fees of \$8 thousand, and \$3 thousand decrease in other general operating costs.

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MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

YEAR ENDED JUNE 30, 2017

Non-Operating Revenues and Expenses

Certain revenue sources including investment income are defined by GASB as non-operating. Non-operating expenses include capital financing costs and other costs related to capital assets. The following summarizes the Research Foundation's non-operating revenues and expenses for the 2017 and 2016 fiscal years:

	<u>2017</u>	<u>2016</u>	<u>Change</u>	<u>% Change</u>
Non-Operating Revenues				
(Expenses):				
Investment income (loss)	\$ 3,464,517	\$ (374,051)	\$ 3,838,568	-1026.2%
Interest income	25,067	19,518	5,549	28.4%
Interest expense	(827,720)	(1,718,965)	891,245	-51.8%
Other non-operating loss	(30,080)	(630,742)	600,662	-95.2%
Total Non-Operating Revenues (Expenses)	<u>\$ 2,631,784</u>	<u>\$ (2,704,240)</u>	<u>\$ 5,336,024</u>	-197.3%

Non-operating investment gain of \$3.5 million in fiscal year 2017 includes realized gain for reinvested dividends and interest of \$1.6 million, and unrealized gains of \$1.9 million associated with increases in market values of investments. The significant change in investment income was due to an overall increase in general market returns in fiscal year 2017 compared to 2016.

As a result of debt pay-off and amendment of existing debt, total interest expense was \$828 thousand in fiscal year 2017, decreasing \$891 thousand (51.8%) from \$1.7 million expense in fiscal year 2016.

Other non-operating loss of \$631 thousand recognized in fiscal year 2016, was to record a one-time payment from a lease settlement reached with a Research Park tenant to accept early termination. The loss also included the recorded expense to write-off the remaining deferred rent holiday provided by the lease, and book value of certain equipment which the Research Foundation was required to transfer the ownership of to Hillsborough County. Ownership of the remaining equipment that had been funded by a grant from the County was conveyed to the Research Foundation in fiscal year 2016, for use by the University to foster economic development and research activity on the Tampa campus. Following this action, the equipment was donated by the Research Foundation to the University and recorded the loss to write off the book value of the equipment as non-operating. The book value of additional equipment transferred in fiscal year 2017, pursuant to this matter, was \$30 thousand.

The Statements of Cash Flows

The statements of cash flows provide information about the Research Foundation's financial results by reporting the major sources and uses of cash. This statement will assist in evaluating the Research Foundation's ability to generate net cash flows, its ability to meet its financial obligations as they come due, and its need for external financing. Cash flows from operating activities show the net cash provided by the operating activities of the Research Foundation. Cash flows from the capital and related financing activities include all property funds and related long-term debt activities. Cash flows from the investing activities show the net source and use of cash related to purchasing or selling investments, and the receipt of income on those investments.

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MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

YEAR ENDED JUNE 30, 2017

The following summarizes cash flows for the 2017 and 2016 fiscal years:

	<u>2017</u>	<u>2016</u>
Cash flows from:		
Operating activities	\$ 5,905,383	\$ 7,766,529
Capital and related financing activities	(12,858,584)	(4,101,291)
Investing activities	<u>7,422,432</u>	<u>(2,628,299)</u>
Net increase in cash and cash equivalents	469,230	1,036,939
Cash and cash equivalents, at beginning of year	<u>4,439,886</u>	<u>3,402,947</u>
Cash and cash equivalents, end of year	<u><u>\$ 4,909,116</u></u>	<u><u>\$ 4,439,886</u></u>

Fiscal year 2017 generated positive cash flow from operations of \$5.9 million. This represents a decrease of \$1.9 million (24%) from \$7.8 million generated in fiscal year 2016. The decrease is attributed to \$695 thousand (5%) decrease in total cash receipts and an increase of \$1.2 million (22%) in total cash disbursements for operating activities. The increase in cash disbursements is primarily due to increased expenditures for contract and grants of \$870 thousand.

Net cash used by capital and financing activities of \$12.9 million includes purchases and construction of capital assets of \$698 thousand, \$11.1 million payment of debt, payment of debt associated interest costs of \$921 thousand and funding seed capital loans of \$150 thousand.

Net cash provided by investing activities of \$7.4 million includes proceeds from sale of investment securities of \$9.4 million less \$2.0 million additional investments.

Capital Assets and Debt Administration

Capital Assets

At June 30, 2017, the Research Foundation had \$67.1 million in capital assets, less accumulated depreciation of \$24.2 million, for net capital assets of \$42.9 million. Depreciation expense totaled \$2.7 million and \$2.8 million for the fiscal years ended June 30, 2017 and 2016, respectively.

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

	<u>2017</u>	<u>2016</u>
Land	\$ 8,739,633	\$ 8,739,633
Construction in process	47,487	38,285
Buildings, net	33,407,783	35,071,429
Equipment, net	<u>692,695</u>	<u>1,076,917</u>
Total capital assets, net	<u><u>\$ 42,887,598</u></u>	<u><u>\$ 44,926,264</u></u>

Additional information about the Research Foundation's capital assets is presented in the notes to the financial statements.

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

YEAR ENDED JUNE 30, 2017

Debt Administration

As of June 30, 2017, the Research Foundation had \$20.5 million in outstanding debt representing a decrease of \$11.1 million, or 35.1%, from the prior fiscal year balance of \$31.6 million. Additional information about the Research Foundation's long-term debt is presented in the notes to the financial statements.

Economic Factors That Will Affect the Future

The USF Innovation Enterprise, which encompasses the USF Research Park, Technology Transfer, and the Tampa Bay Technology Incubator, contributes to a robust innovation-based ecosystem to include community startups and corporate partnerships with the University.

Strategic master planning with the Research Park as the gateway to the Innovation District is underway. All activities would further the Innovation District Concept to create a vibrant community, and support the University Strategic Plan. The vision is for a vibrant, engaging mixed-use community which will enhance the dynamic biotechnology cluster by continuing to position scientists and entrepreneurs side-by-side to develop innovations and advancements that succeed in both the laboratory and in the marketplace.

The Research Park is finding success with its mission as evidenced by its housing of 5 of the top 20 funded University faculty in its research facilities, to include the #1 research funded faculty position as recognized for fiscal year 2017. Additionally, the private sector tenants continue to demonstrate positive job creation, collaboration with University faculty, 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 ongoing 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.

The Research Foundation's economic outlook is also related to continuing growth of intellectual royalty and licensing fees. These income sources are expected to increase in fiscal year 2018. Revenue from administrative fees to meet operational overhead costs is earned through the University's placement of private industry contracts and grants to the Research Foundation for post award management.

Operating profits are invested in the research infrastructure throughout the University System. In line with revenue growth strategies, new infrastructure investments by the Research Foundation will be reviewed for return on investment. Net operating profits will be available for future research infrastructure investment.

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, 2017

ASSETS

Current Assets:

Cash	\$ 3,884,116
Investments	30,520,653
Accounts receivable, net	972,042
Other current assets	52,269
Total Current Assets	35,429,080

Noncurrent Assets:

Restricted cash	1,025,000
Capital assets, net	42,887,598
Developer rights to Research Park, net	7,341,066
Other investments	235,606
Non-current receivables	82,684
Notes receivables, net	432,000
Total Noncurrent Assets	52,003,954
Total Assets	87,433,034

DEFERRED OUTFLOWS OF RESOURCES

Derivative investment - interest rate swap	156,607
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LIABILITIES

Current Liabilities:

Accounts payable and accrued liabilities	1,396,309
Due to University of South Florida	8,018,082
Current portion of notes payable	1,590,000
Unearned revenues	329,716
Total Current Liabilities	11,334,107

Noncurrent Liabilities:

Notes payable, less current portion	18,875,000
Derivative investment - interest rate swap liability	156,607
Total Noncurrent Liabilities	19,031,607
Total Liabilities	30,365,714

NET POSITION

Net investment in capital assets	23,447,598
Unrestricted	33,776,329
Total Net Position	\$ 57,223,927

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

YEAR ENDED JUNE 30, 2017

Operating Revenues:	
Property rental revenues	\$ 7,151,463
Royalties, licenses, and option fees	2,614,265
Incubator sponsor revenue	1,248,250
Incubator program revenue	516,038
Contracts and grants	512,788
Administrative fees	160,411
Total Operating Revenues	<u>12,203,215</u>
Operating Expenses:	
Property rental expenses	5,249,805
Incubator program expenses	1,125,892
Inventor royalties	852,503
Inventing department and other royalties	577,338
Other intellectual property costs	229,269
Contracts and grants	512,788
University support	77,085
Seed capital expense	75,000
Management and general	933,429
Total Operating Expenses	<u>9,633,109</u>
Operating Income	<u>2,570,106</u>
Non-Operating Revenues (Expenses):	
Investment income	3,464,517
Interest income	25,067
Interest expense	(827,720)
Other non-operating loss	(30,080)
Total Non-Operating Revenues	<u>2,631,784</u>
Increase in net position	5,201,890
Total net position, beginning of year	<u>52,022,037</u>
Total net position, end of year	<u><u>\$ 57,223,927</u></u>

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

YEAR ENDED JUNE 30, 2017

Cash flows from operating activities:

Property rental receipts	\$ 7,369,603
Royalties, licenses, and option fees	2,540,639
Contract and grant receipts	652,652
Administrative fee receipts	160,411
Incubator program and sponsor receipts	<u>1,765,525</u>
Total Receipts	<u>12,488,830</u>
Property rental disbursements	(2,417,720)
Intellectual property disbursements	(1,460,042)
Contract and grant disbursements	(1,143,668)
Incubator program disbursements	(1,125,892)
University support, management and general	<u>(436,125)</u>
Total Disbursements	<u>(6,583,447)</u>
Net cash flows from operating activities	<u>5,905,383</u>

Cash flows from capital and related financing activities:

Acquisition of capital assets	(697,784)
Principal payments on notes payable	(11,090,000)
Interest paid on notes and swap liabilities	(920,800)
Issuance of notes receivable	<u>(150,000)</u>
Net cash flows from capital and related financing activities	<u>(12,858,584)</u>

Cash flows from investing activities:

Sale of investments	9,404,438
Purchase of investments	(2,000,000)
Investment income	<u>17,994</u>
Net cash flows from investing activities	<u>7,422,432</u>

Net increase in cash	469,230
Cash, beginning of year	<u>4,439,886</u>
Cash, end of year	<u>\$ 4,909,116</u>

Cash:

Unrestricted	3,884,116
Restricted	<u>1,025,000</u>
	<u>\$ 4,909,116</u>

(continued)

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

YEAR ENDED JUNE 30, 2017

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

Operating income	\$ 2,570,106
Adjustments to reconcile operating income to net cash flows from operating activities:	
Depreciation and amortization expense	2,822,283
Accounts receivable provision for bad debts	52,876
Notes receivable provision for net realizable value	75,000
Change in assets and liabilities:	
Accounts receivable and other receivables	(91,274)
Other current assets	(61,743)
Accounts payable and accrued liabilities	267,796
Due to University of South Florida	168,973
Unearned revenue	101,366
Net cash flows from operating activities	<u>\$ 5,905,383</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>\$ 340,461</u>
Net loss on disposal of capital assets	<u>\$ (30,080)</u>

Supplemental Disclosure of Noncash Investing Activities

Net unrealized gain on investments	<u>\$ 3,446,523</u>
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UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2017

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 was formed to provide broad and flexible financial mechanisms 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 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. 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. Patent costs recovered by the Research Foundation are repaid to the University.

The Research Foundation also 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.

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 FINANCIAL STATEMENTS

JUNE 30, 2017

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 non-operating 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.

Restricted Cash – Cash whose use is restricted for debt service is segregated on the Statement of Net Position.

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 50% of the outstanding note balance, for estimated net realizable value in consideration of conversion features associated with the note.

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.

Interest expense on borrowings incurred during the construction or upgrade of qualifying assets is capitalized and added to the cost of the underlying assets. There was no capitalized interest for the year ended June 30, 2017.

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 agreements (see Note 10) meet this criterion.

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

JUNE 30, 2017

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, 2017 through October 6, 2017, the date the financial statements were available for issuance.

Note 3—Investments and other investments

At June 30, 2017, 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	\$ 176,637	\$ 176,637	\$ -	\$ -	\$ -
Short-Term Bond Index Funds	2,023,874	12,143	2,007,683	4,048	-
Bonds	1,235,480	94,714	336,524	255,832	548,410
Equity Securities	1,619,860	No Maturity			
Mutual Funds	3,044,395	No Maturity			
Partnership Accounts	150,000	No Maturity			
Pooled Investments:					
Money Market Funds	140,291	140,291	-	-	-
Bond Mutual Funds	3,063,812	-	-	3,063,812	-
Partnership Funds	3,970,497	No Maturity			
Equity Mutual Funds	15,331,413	15,331,413	-	-	-
	<u>\$ 30,756,259</u>	<u>\$ 15,755,198</u>	<u>\$ 2,344,207</u>	<u>\$ 3,323,692</u>	<u>\$ 548,410</u>

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2017

Note 3—Investments and other investments (continued)

Pooled investments represent the Research Foundation's interest in the University of South Florida ("USF") 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 sixty 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, 2017.

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 five percent 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.

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, 2017, the book balances of deposits were \$4,909,116 and the bank balances were \$4,988,995. 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, 2017, the Research Foundation had bank balances of approximately \$4,700,000 in excess of these insured limits.

Interest Rate and Credit 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 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 and Standard and 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.

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

JUNE 30, 2017

Note 3—Investments and other investments (continued)

At June 30, 2017, 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	\$ 316,928	\$ -	\$ -	\$ -	\$ -	\$ 316,928
Short-Term Bond Index	2,023,874	28,334	267,151	835,860	880,385	12,144
Bonds	1,235,480	320,140	131,698	233,523	192,651	357,468
Mutual Funds	3,044,395	-	-	-	-	3,044,395
Bond Mutual Funds	3,063,812	341,252	39,872	254,136	1,156,835	1,271,717
	<u>\$ 9,684,489</u>	<u>\$ 689,726</u>	<u>\$ 438,721</u>	<u>\$ 1,323,519</u>	<u>\$ 2,229,871</u>	<u>\$ 5,002,652</u>

Debt instruments whose quality is not rated includes \$1,524,974 of US Government/Agency, \$33,959 of not rated short-term investments, \$316,928 of not rated money market funds, and \$3,126,791 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).

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.

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

JUNE 30, 2017

Note 3—Investments and other investments (continued)

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 US 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 FINANCIAL STATEMENTS

JUNE 30, 2017

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, 2017.

	Total Fair Value	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
Investments by Fair Value Level				
Money Market Accounts	\$ 176,637	\$ 176,637	\$ -	\$ -
Short-Term Corporate Bond Index Funds	2,023,874	2,023,874	-	-
Bonds	1,235,480	-	1,235,480	-
Equity Securities	1,619,860	1,619,860	-	-
Mutual Funds	3,044,395	3,044,395	-	-
Partnership Accounts	150,000	-	-	150,000
Total Investments by Fair Value Level	8,250,246	\$ 6,864,766	\$ 1,235,480	\$ 150,000
Investments Measured at Net Asset Value (NAV)				
Pooled Investments	22,506,013			
Total Investments Measured at NAV	22,506,013			
Total Investments	\$ 30,756,259			
Investment Derivative Instruments				
Interest Rate Swap Agreement	\$ 156,607			\$ 156,607
Total Investment Derivative Instruments	\$ 156,607			\$ 156,607

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

JUNE 30, 2017

Note 4—Accounts receivable

Accounts receivable consist of the following at June 30, 2017:

Royalty and license fees	\$ 1,210,193
Incubator sponsor support	60,000
Property leases	30,270
Other receivables	7,873
Allowance for doubtful accounts	(336,294)
	<u>\$ 972,042</u>

Note 5—Capital assets

Capital assets consist of the following at June 30, 2017:

	<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	38,285	47,487	(38,285)	47,487
Total capital assets not being depreciated	<u>8,777,918</u>	<u>47,487</u>	<u>(38,285)</u>	<u>8,787,120</u>
Capital assets being depreciated:				
Buildings	54,355,508	688,582	-	55,044,090
Equipment	3,355,817	-	(52,395)	3,303,422
Total capital assets being depreciated	<u>57,711,325</u>	<u>688,582</u>	<u>(52,395)</u>	<u>58,347,512</u>
Less accumulated depreciation for:				
Buildings	(19,284,079)	(2,352,228)	-	(21,636,307)
Equipment	(2,278,900)	(354,142)	22,315	(2,610,727)
Total accumulated depreciation	<u>(21,562,979)</u>	<u>(2,706,370)</u>	<u>22,315</u>	<u>(24,247,034)</u>
Total capital assets being depreciated, net	<u>36,148,346</u>	<u>(2,017,788)</u>	<u>(30,080)</u>	<u>34,100,478</u>
Total capital assets, net	<u>\$ 44,926,264</u>	<u>\$ (1,970,301)</u>	<u>\$ (68,365)</u>	<u>\$ 42,887,598</u>

Note 6—Developer rights to Research Park

Other non-current 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 \$1,043,204. 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 \$115,913 for fiscal year 2017.

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

JUNE 30, 2017

Note 7—Notes receivable Seed Capital Accelerator Program

In September 2013, 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 forms the financial basis of the venture investment fund. During fiscal year 2017, investment gains of \$3,471,111 were recognized and accordingly, \$867,778 was allocated to the fund during the year. The balance of the venture investment fund is \$3,910,916 at June 30, 2017.

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 (Program) has been designed to support new and existing Tampa Bay Technology Incubator affiliated start-up companies that have been formed, based on the licensing of University technologies.

The 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 \$432,000 and classified as noncurrent on the Statement of Net Position.

During fiscal year 2017, the Program provided total funding of \$150,000 to three companies.

The following is a schedule of maturities:

<u>Year</u>	<u>Amount</u>
2018	\$ -
2019	389,500
2020	150,000
2021	205,000
2022	150,000
Total notes receivable	894,500
Less allowance for uncollectable	(462,500)
	<u>\$ 432,000</u>

Note 8—Accounts payable and accrued liabilities

Accounts payable and accrued liabilities consist of the following at June 30, 2017:

Vendors payable	\$ 383,475
Inventor royalties payable	640,725
Escrow payable	226,387
Interest payable	9,651
Other royalties payable	5,250
Other payables	130,821
	<u>\$ 1,396,309</u>

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

JUNE 30, 2017

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 1.96% at June 30, 2017. 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 variable rate note with pay fixed interest rate swap 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.

In 2013, the Research Foundation issued Series 2013-D Note to refund the outstanding Series 2004C Bond. The terms of the note included an interest rate of One-Month LIBOR, to be payable monthly with principal payable annually. The Note was paid off in fiscal year 2017.

	June 30, 2016	Increases	Reductions	June 30, 2017	Amounts Due Within One Year
Notes Payable:					
2013-A	\$ 3,800,000	\$ -	\$ (900,000)	\$ 2,900,000	\$ 900,000
2013-B	18,230,000	-	(665,000)	17,565,000	690,000
2013-D	9,525,000	-	(9,525,000)	-	-
Total Notes Payable	<u>\$ 31,555,000</u>	<u>\$ -</u>	<u>\$ (11,090,000)</u>	<u>\$ 20,465,000</u>	<u>\$ 1,590,000</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, 2017, \$1,025,000 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 and cash equivalents on the Statement of Net Position.

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

JUNE 30, 2017

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
2018	\$ 1,590,000	\$ 693,339
2019	1,720,000	608,025
2020	1,745,000	560,022
2021	775,000	467,447
2022	805,000	441,927
2023 - 2027	4,525,000	1,817,648
2028 - 2032	5,480,000	984,263
2033 - 2035	3,825,000	134,951
	\$ 20,465,000	\$ 5,707,622

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, 2017, 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 agreements, as further discussed in Note 10, was \$827,720 for fiscal year 2017.

Note 10—Derivative instruments

In 2001 and in 2006, the Research Foundation entered into interest rate swap agreements to limit the effect 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.

The terms of the swap agreements provided that the Research Foundation pay a monthly fixed rate and receive monthly a variable rate equal to 67% of the one-month LIBOR. The effect of the agreements was to set the interest rates at a fixed rate through the term of the swap agreements. During fiscal year 2017, two of the interest rate swap agreements matured and were not replaced. At June 30, 2017, only the 2001 swap agreement remains in effect.

The fair value of the swap agreement is estimated taking into account current interest rates and the credit worthiness of the counterparties.

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

JUNE 30, 2017

Note 10—Derivative instruments (continued)

The fair value and key terms of the Research Foundation’s swap agreement at June 30, 2017 are as follows:

Notes	Notional Amount	Effective Date	Maturity Date	Fixed Rate	Estimated Fair Value
Series 2013-A	\$ 2,900,000	06/01/01	12/01/19	4.560%	\$ (156,607)

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, 2017 and as such, is presented as a non-current liability in the accompanying Statement of Net Position. The reported fair value is calculated using the marked-to-market method by an independent third party.

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 A-1 (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.

Basis Risk – The Research Foundation is exposed to basis risk because the variable rate payments are calculated on the basis of a 67% of LIBOR (a taxable rate index) and the Research Foundation’s variable rate interest obligations on the note is determined in the tax-exempt market. Should the relationship between LIBOR and the tax-exempt market change and move to converge, or should the notes trade at levels worse (higher in rate) in relation to the tax-exempt market, the Research Foundation’s all-in costs would increase.

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 agreements of \$222,952 for fiscal year 2017.

The following is a schedule of expected future interest payments required under the swap agreement as of June 30, 2017:

Year	Amount
2018	\$ 108,300
2019	64,600
2020	19,000

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

JUNE 30, 2017

Note 11—Lease revenue

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, 2017:

Buildings, at cost	\$ 54,278,243
Accumulated depreciation	<u>(21,332,369)</u>
Net investments in assets subject to operating leases	<u><u>\$ 32,945,874</u></u>

Depreciation expense related to the buildings leased to other parties was \$2,279,782 for fiscal year 2017.

Future minimum lease payments expected to be received under noncancellable operating leases as of June 30, 2017 are as follows:

<u>Year</u>	<u>Total Amount</u>	<u>Related Party</u>
2018	\$ 7,257,646	\$ 6,512,099
2019	6,974,435	6,329,248
2020	6,826,465	6,331,329
2021	6,527,048	6,182,863
2022	5,052,707	4,987,442
2023	5,054,651	4,989,386

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 \$6,297,082 for fiscal year 2017.

The Research Foundation invoices intellectual property licensees for reimbursement of patent costs that are due to the University. Total amounts invoiced of \$573,433 for patent costs recovery in fiscal year 2017 are not reflected in the accompanying Statement of Revenues, Expenses and Changes in Net Position. In fiscal year 2017, the Research Foundation paid \$394,806 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 \$422,559, 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 USF Tampa Bay Technology Incubator Program. During fiscal year 2017, the Research Foundation received \$700,000 from the University for support of the Incubator program.

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

JUNE 30, 2017

Note 12—Related party transactions (continued)

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. This includes processing sponsor invoicing and related expenditures for the agreements. Expenditures processed through the Research Foundation in fiscal year 2017 totaled \$2,252,587, of which \$1,296,793 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 \$52,374 for these services in fiscal year 2017. The custodial fund balance for these agreements of \$816,261 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 2017, \$854,074 of cash receipts and \$826,078 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 2017, the Research Foundation received \$59,058 in administrative fees for these services. The custodial cash balance at June 30, 2017 of \$253,403 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 \$4,024,470 as of June 30, 2017, 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 2017, the Research Foundation recognized royalty distribution expenses of \$353,829 and \$181,893 to the departments and colleges of the University research funds, of which \$335,546 and \$196,176 respectively, were distributed. Accrued royalties payable of \$349,795 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 Research Park. As of June 30, 2017, funding received in excess of costs incurred was \$598,981, which is included in the due to University payable in the Statement of Net Position.

Periodically, as a direct service organization of the University, the Research Foundation assumes responsibility for various University initiatives. At June 30, 2017, total custodial funds of \$1,524,506, 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 (see Note 7). These loans remain outstanding at June 30, 2017.

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 2017 salary and fringe benefit costs were \$1,300,856.

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

YEAR ENDED JUNE 30, 2017

	Program Services	Management and General	Total
Depreciation Expense	\$ 2,706,009	\$ 361	\$ 2,706,370
Royalty Expense	1,429,841	-	1,429,841
Utilities	1,427,893	-	1,427,893
Salary and Wages	708,855	592,289	1,301,144
Repairs and Maintenance	1,129,382	26,060	1,155,442
Fringe Benefits	122,252	192,060	314,312
Insurance	258,313	10,855	269,168
Materials and Supplies	169,953	16,874	186,827
Technology Costs	181,126	-	181,126
Bad Debt Expense	127,876	-	127,876
Amortization Expense	115,913	-	115,913
Professional Fees	37,654	75,675	113,329
Grant Close Out and Administrative Fees	108,041	-	108,041
Subscriptions and Memberships	54,156	3,450	57,606
Real Estate Tax	36,639	-	36,639
Independent Contractors	33,532	-	33,532
Telephone	16,881	10,211	27,092
Advertising	12,021	-	12,021
Travel	7,599	1,368	8,967
Bank Fees	7,485	599	8,084
Printing Costs	2,526	1,354	3,880
Rental Expense	3,267	-	3,267
Participant Stipends and Tuition	2,375	-	2,375
Postage & Freight	91	2,273	2,364
Total Operating Expenses	<u>\$ 8,699,680</u>	<u>\$ 933,429</u>	<u>\$ 9,633,109</u>

**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, 2017, 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 6, 2017.

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, flowing style.

Tampa, Florida
October 6, 2017