

**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, 2019

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
University of South Florida
Research Foundation, Inc.
Tampa, Florida

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities and aggregate remaining fund information 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, 2019, and the related notes to the financial statements, which collectively comprise the Research Foundation's basic financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinions 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 opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and aggregate remaining fund information of the Research Foundation, as of June 30, 2019, and the respective 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

Emphasis of Matter

As discussed in Note 2 to the financial statement, in fiscal year 2019, the Research Foundation adopted the provisions of Governmental Accounting Standards Board Statement No. 84, *Fiduciary Activities*. Our opinions are not modified with respect to this matter.

Required Supplementary Information

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

Other Information

Our audit was conducted for the purpose of forming 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 10, 2019, 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 solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Research Foundation's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Research Foundation's internal control over financial reporting and compliance.

Cherry Bekant LLP

Tampa, Florida
October 10, 2019

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

YEAR ENDED JUNE 30, 2019

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, 2019, 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.

For comparative purposes to fiscal year 2019, the financial statements for fiscal year 2018 have been restated to remove the assets and liabilities for fiduciary funds, as well as the revenue and expenditures related to fiduciary activities for the USF Incubator program as required by the adoption of GASB 84, *Fiduciary Activities*.

Financial Highlights

The Research Foundation's assets totaled \$96.2 million at June 30, 2019. This balance reflects an increase of \$6.7 million (7.5%) from total assets of \$89.5 million at June 30, 2018. Total liabilities increased \$2.8 million (10.2%) to \$29.8 million at June 30, 2019 from \$27.0 million at June 30, 2018. The Research Foundation's net position increased by \$3.9 million (6.3%), reaching a year-end balance of \$66.5 million.

The Research Foundation's operating revenues were \$13.4 million in fiscal year 2019, for an increase of \$534 thousand (4.2%) from the prior fiscal year. Operating expenses in fiscal year 2019 were \$11.1 million for an increase of \$304 thousand (2.8%) from fiscal year 2018. Operating income for fiscal year 2019 was \$2.3 million, for an increase of \$230 thousand (11.0%) from the prior fiscal year.

Nonoperating revenue net of nonoperating expense was \$1.6 million in fiscal year 2019, for a 34.2% decrease from the \$2.5 million net nonoperating revenue in fiscal year 2018. Fiscal year 2019 increase in net position was \$3.9 million as a result of the excess of revenues over expenses.

Overview of Financial Statements

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

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

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

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

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

YEAR ENDED JUNE 30, 2019

Condensed Statements of Net Position

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

	<u>2019</u>	<u>(as restated) 2018</u>
ASSETS		
Current assets	\$ 44,327,060	\$ 39,727,536
Restricted cash	1,120,834	1,100,000
Capital assets, net	42,853,560	40,822,360
Other investments	703,670	322,037
Other noncurrent assets	<u>7,234,492</u>	<u>7,528,762</u>
Total Assets	<u>96,239,616</u>	<u>89,500,695</u>
DEFERRED OUTFLOWS OF RESOURCES		
Interest rate swap	<u>15,608</u>	<u>58,610</u>
LIABILITIES		
Current	11,117,106	9,791,706
Noncurrent	<u>18,650,196</u>	<u>17,213,610</u>
Total Liabilities	<u>29,767,302</u>	<u>27,005,316</u>
NET POSITION		
Net investment in capital assets	23,313,788	23,047,360
Unrestricted	<u>43,174,134</u>	<u>39,506,629</u>
Total Net Position	<u>\$ 66,487,922</u>	<u>\$ 62,553,989</u>

Current assets were \$44.3 million at June 30, 2019, for an increase of \$4.6 million (11.6%) from the prior fiscal year. The increase in current assets includes an increase in cash of \$297 thousand (8.6%), increase in investments of \$5.1 million (14.9%) and a decrease of \$867 thousand (54%) in accounts receivable and notes receivable. Investment activity in fiscal year 2019 included additional \$3.0 million investment of funds and investment gains of \$2.1 million.

Capital assets increased \$2.1 million (5.0%) to \$42.9 million at June 30, 2019 from \$40.8 million at June 30, 2018. The net increase resulted from capital asset additions of \$4.6 million which includes a building acquired under a capital lease obligation of \$3.5 million, less depreciation charges of \$2.5 million for fiscal year 2019.

Total liabilities increased \$2.8 million (10.2%) to \$29.8 million at June 30, 2019 from \$27.0 million at June 30, 2018. The increase in liabilities resulted from entering into a capital lease obligation with another Direct Support Organization of the University of South Florida (the "University") to acquire a building within the Research Park in the amount of \$3.5 million, the present value of future minimum lease payments. Scheduled principal payments on notes payable of \$1.7 million occurred in fiscal year 2019, with an offsetting increase of \$1.0 million in current liabilities for accounts payable and Due to the University. The fair value of the interest rate swap agreement decreased as a result of debt payments.

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

YEAR ENDED JUNE 30, 2019

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

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

	2019	(as restated) 2018
Operating revenues	\$ 13,378,765	\$ 12,844,436
Operating expenses	11,061,305	10,757,277
Operating income	2,317,460	2,087,159
Net nonoperating revenues	1,616,473	2,457,246
Increase in net position	3,933,933	4,544,405
Cummulative effect due to the adoption of GASB No. 84	-	785,657
Net position, beginning of year	62,553,989	57,223,927
Net position, end of year	<u>\$ 66,487,922</u>	<u>\$ 62,553,989</u>

Operating Revenues

Operating revenues by source for the fiscal years ended June 30, 2019 and 2018 were as follows:

	2019	(as restated) 2018	Increase (Decrease)	% Change
Property rental revenues	\$ 8,873,120	\$ 8,267,554	\$ 605,566	7.3%
Royalties, licenses, and option fees	3,899,439	4,034,562	(135,123)	-3.3%
Contracts and grants	363,324	325,524	37,800	11.6%
Administrative fees	242,882	216,796	26,086	12.0%
Total Operating Revenues	<u>\$ 13,378,765</u>	<u>\$ 12,844,436</u>	<u>\$ 534,329</u>	4.2%

Property rental revenues were \$8.9 million in fiscal year 2019 for an increase of \$606 thousand (7.3%) as compared to prior fiscal year. \$353 thousand of revenue growth occurred from scheduled lease escalations, as well as increased occupancy within Research Foundation owned buildings, and \$253 thousand was generated from leased office space.

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

YEAR ENDED JUNE 30, 2019

Operating Expenses

The following summarizes the operating expenses for the fiscal years ended June 30, 2019 and 2018:

	<u>2019</u>	<u>(as restated) 2018</u>	<u>Increase (Decrease)</u>	<u>% Change</u>
Property rental expenses	\$ 6,780,301	\$ 6,432,681	\$ 347,620	5.4%
Inventor royalties	1,377,244	985,916	391,328	39.7%
Inventing department and other royalties	769,297	566,689	202,608	35.8%
Intellectual property costs	430,768	1,383,587	(952,819)	-68.9%
Seed capital expense	382,050	25,000	357,050	1428.2%
Contracts and grants	363,324	325,524	37,800	11.6%
University support	76,350	83,790	(7,440)	-8.9%
Management and general	881,971	954,090	(72,119)	-7.6%
Total Operating Expenses	<u>\$ 11,061,305</u>	<u>\$ 10,757,277</u>	<u>\$ 304,028</u>	2.8%

Property rental expenses include Research Park operating expenses and costs associated with the operating lease of office space. In fiscal year 2019, the combined expense increased \$348 thousand (5.4%) to \$6.8 million. Property rental expenses associated with the initial lease year of office space were \$584 thousand, offset by a decrease in Research Park operating expenses of \$236 thousand (3.7%).

Total intellectual property costs of \$2.6 million to include royalties of \$2.1 million and other direct technology costs, decreased \$359 thousand (12.2%) in fiscal year 2019 due to a decrease in direct costs associated with intellectual property revenue, offset by increased royalty expense on revenue subject to royalties.

In fiscal year 2019, an additional expense to reserve for unlikely collection of the Seed Capital notes receivables was recorded to reduce the estimated net realizable value of the notes and interest receivable, given consideration of conversion features associated with the note and specific review of the start-up company's ability to pay.

Nonoperating Revenues and Expenses

Certain revenue sources including investment income are defined by GASB as nonoperating. Nonoperating expenses include capital financing costs and other costs related to capital assets. The following summarizes the Research Foundation's nonoperating revenues and expenses for the 2019 and 2018 fiscal years:

	<u>2019</u>	<u>2018</u>	<u>Change</u>	<u>% Change</u>
Nonoperating Revenues				
(Expenses):				
Investment income	\$ 2,212,120	\$ 3,117,270	\$ (905,150)	-29.0%
Interest income	25,934	26,865	(931)	-3.5%
Interest expense	(621,581)	(686,889)	65,308	-9.5%
Total Net Nonoperating Revenues	<u>\$ 1,616,473</u>	<u>\$ 2,457,246</u>	<u>\$ (840,773)</u>	-34.2%

Nonoperating investment income of \$2.2 million in fiscal year 2019 includes realized gain of \$1.8 million for reinvested dividends and interest, and unrealized gains of \$400 thousand associated with increases in market values of investments.

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

YEAR ENDED JUNE 30, 2019

Condensed Statements of Cash Flows

The following summarizes cash flows for the 2019 and 2018 fiscal years:

	<u>2019</u>	<u>(as restated) 2018</u>
Cash flows from:		
Operating activities	\$ 6,992,154	\$ 5,083,065
Capital and related financing activities	(3,423,993)	(2,973,646)
Investing activities	<u>(3,250,603)</u>	<u>(941,045)</u>
Net increase in cash and cash equivalents	317,558	1,168,374
Cash and cash equivalents, beginning of year	4,553,814	4,909,116
Less restatement for fiduciary cash under GASB No. 84	-	<u>(1,523,676)</u>
Cash and cash equivalents, end of year	<u>\$ 4,871,372</u>	<u>\$ 4,553,814</u>

Fiscal year 2019 generated positive cash flow from operations of \$7.0 million.

Cash from operating activities were used for capital and financing activities to include purchases and construction of capital assets of \$1.1 million, payment of debt \$1.7 million, and \$617 thousand payment of debt associated interest costs.

Cash from operating activities also provided \$3.3 million to use for investing activities.

Capital Assets

At June 30, 2019, the Research Foundation had \$72.4 million in capital assets, less accumulated depreciation of \$29.5 million, for net capital assets of \$42.9 million. Depreciation expense totaled \$2.5 million and \$2.8 million for the fiscal years ended June 30, 2019 and 2018, respectively.

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

	<u>2019</u>	<u>2018</u>
Land	\$ 8,739,633	\$ 8,739,633
Construction in process	604,123	181,920
Buildings, net	33,261,664	31,508,251
Equipment, net	<u>248,140</u>	<u>392,556</u>
Total capital assets, net	<u>\$ 42,853,560</u>	<u>\$ 40,822,360</u>

Debt Administration

At June 30, 2019, the Research Foundation had \$20.7 million in outstanding debt representing an increase of \$1.8 million, or 9.2%, from the prior fiscal year balance of \$18.9 million. As further disclosed in the notes to the financial statements, a capital lease obligation with \$3.5 million present value of minimum lease payments was entered into in fiscal year 2019.

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

YEAR ENDED JUNE 30, 2019

Economic Factors That Will Affect the Future

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

Leases for existing structures and ground lease transactions within the Research Park are a significant source of revenue for the Research Foundation. Occupancy within the Research Park is at near capacity. While there is 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.

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, 2019

ASSETS

Current Assets:

Cash	\$ 3,750,538
Investments	39,680,030
Accounts receivable, net	690,156
Notes receivable, net	37,500
Other current assets	168,836
Total Current Assets	<u>44,327,060</u>

Noncurrent Assets:

Restricted cash	1,120,834
Capital assets, net	42,853,560
Developer rights to Research Park, net	7,109,243
Other investments	703,670
Noncurrent receivables	17,749
Notes receivables, net	107,500
Total Noncurrent Assets	<u>51,912,556</u>
Total Assets	<u>96,239,616</u>

DEFERRED OUTFLOWS OF RESOURCES

Derivative investment - interest rate swap	<u>15,608</u>
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LIABILITIES

Current Liabilities:

Accounts payable and accrued liabilities	2,274,807
Due to University of South Florida	6,626,975
Current portion of notes payable	1,745,000
Current portion of capital lease obligation	281,018
Unearned revenues	189,306
Total Current Liabilities	<u>11,117,106</u>

Noncurrent Liabilities:

Notes payable, less current portion	15,410,000
Capital lease obligation, less current portion	3,224,588
Derivative investment - interest rate swap liability	15,608
Total Noncurrent Liabilities	<u>18,650,196</u>
Total Liabilities	<u>29,767,302</u>

NET POSITION

Net investment in capital assets	23,313,788
Unrestricted	43,174,134
Total Net Position	<u>\$ 66,487,922</u>

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

YEAR ENDED JUNE 30, 2019

Operating Revenues:	
Property rental revenues	\$ 8,873,120
Royalties, licenses, and option fees	3,899,439
Contracts and grants	363,324
Administrative fees	242,882
Total Operating Revenues	<u>13,378,765</u>
Operating Expenses:	
Property rental expenses	6,780,301
Inventor royalties	1,377,244
Inventing department and other royalties	769,297
Intellectual property costs	430,768
Seed capital expense	382,050
Contracts and grants	363,324
University support	76,350
Management and general	881,971
Total Operating Expenses	<u>11,061,305</u>
Operating Income	<u>2,317,460</u>
Nonoperating Revenue (Expense):	
Investment income	2,212,120
Interest income	25,934
Interest expense	(621,581)
Total Net Nonoperating Revenue	<u>1,616,473</u>
Increase in net position	3,933,933
Total net position, beginning of year	<u>62,553,989</u>
Total net position, end of year	<u>\$ 66,487,922</u>

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

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

YEAR ENDED JUNE 30, 2019

Cash flows from operating activities:	
Property rental receipts	\$ 8,661,826
Royalties, licenses, and option fees	4,192,329
Contract and grant receipts	414,270
Administrative fee receipts	242,882
Total Receipts	<u>13,511,307</u>
Property rental disbursements	(3,357,635)
Intellectual property disbursements	(2,938,728)
Contract and grant disbursements	(461,351)
University support, management and general	238,561
Total Disbursements	<u>(6,519,153)</u>
Net cash flows from operating activities	<u>6,992,154</u>
Cash flows from capital and related financing activities:	
Acquisition of capital assets	(1,062,413)
Principal payments on notes payable	(1,720,000)
Interest paid on notes and swap liabilities	(616,580)
Issuance of note receivable	(25,000)
Net cash flows from capital and related financing activities	<u>(3,423,993)</u>
Cash flows from investing activities:	
Sale of investments	125,504
Purchase of investments	(3,376,107)
Net cash flows from investing activities	<u>(3,250,603)</u>
Net increase in cash	317,558
Cash, beginning of year, as restated	<u>4,553,814</u>
Cash, end of year	<u>\$ 4,871,372</u>
Cash:	
Unrestricted	\$ 3,750,538
Restricted	<u>1,120,834</u>
	<u>\$ 4,871,372</u>

(continued)

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

YEAR ENDED JUNE 30, 2019

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

Operating income	\$ 2,317,460
Adjustments to reconcile net operating revenues (expenses) to net cash flows from operating activities:	
Depreciation and amortization expense	2,648,092
Accounts receivable provision for bad debts	64,879
Notes and interest receivable provision for net realizable value	382,050
Other noncash	4,640
Change in assets and liabilities:	
Accounts receivable and other receivables	682,058
Other current assets	(66,565)
Accounts payable and accrued liabilities	537,627
Due to University of South Florida	399,121
Unearned revenue	22,792
Net cash flows from operating activities	<u>\$ 6,992,154</u>

Supplemental disclosure of noncash capital and financing activities:

Reduction in derivative investment through a reduction in deferred outflow of resources for the interest rate swap	<u>\$ (43,002)</u>
Capital asset financed by capital lease	<u>\$ 3,505,606</u>

Supplemental disclosure of noncash investing activities:

Net unrealized gain on investments	<u>\$ 2,136,956</u>
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UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.
STATEMENT OF FIDUCIARY NET POSITION

JUNE 30, 2019

	Custodial Funds
ASSETS	
Cash	\$ 2,255,133
Receivables	187,441
Total Assets	<u>2,442,574</u>
LIABILITIES	
Accounts payable	<u>67,014</u>
Total Liabilities	<u>67,014</u>
NET POSITION	
Restricted for USF Incubator Program	1,045,023
Restricted for USF Economic Development	478,352
Restricted for USF Institute for Advanced Discovery & Innovation	339,958
Restricted for Graphicstudio	229,598
Restricted for USF St Petersburg Incubator Support	200,000
Restricted for USF Veterans Reintegration	82,629
Total Net Position	<u>\$ 2,375,560</u>

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

YEAR ENDED JUNE 30, 2019

	Custodial Funds
Additions:	
Graphicstudio revenue	\$ 1,189,501
Incubator program revenue	757,764
Incubator sponsor support	514,550
Total Additions	<u>2,461,815</u>
Deductions:	
Graphicstudio expenditures	1,040,203
Program expenditures	432,396
Administrative fees	137,332
Total Deductions	<u>1,609,931</u>
Net increase in fiduciary net position	851,884
Net position, beginning of year	<u>1,523,676</u>
Net position, end of year	<u><u>\$ 2,375,560</u></u>

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.

NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2019

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 (“DSO”) of the University as provided for under Section 1004.28, Florida Statutes.

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

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

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

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

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

UNIVERSITY OF SOUTH FLORIDA RESEARCH FOUNDATION, INC.

NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2019

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's financial statements are presented in the form of an enterprise fund and a fiduciary custodial fund.

Custodial funds are used to account for assets held by or as an agent for the benefit of other organizations outside the reporting entity, to include the University. Custodial funds are custodial in nature and do not involve measurement of results of operations. Custodial funds include the USF Incubator, USF Economic Development, USF Institute for Advanced Discovery & Innovation, USF St. Petersburg Incubator Support, USF Veterans Reintegration Office, and Graphicstudio.

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. The Research Foundation's custodial funds are presented in the fund financial statements. By definition, these assets are being held for the benefit of a third party and cannot be used to address activities or obligations of the Research Foundation. Accordingly, these funds are not incorporated into the Research Foundation's statements.

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

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

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

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

Notes Receivable – Notes receivable consists of amounts funded to companies through the Seed Capital Accelerator Program (see Note 7) and are recorded at net realizable value. The Research Foundation's policy is to record an initial provision for 50% of the outstanding note balance, and increase the allowance when collection appears unlikely for the estimated net realizable value, given consideration of conversion features associated with the note and specific review of the start-up company.

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

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

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

JUNE 30, 2019

Note 2—Summary of significant accounting policies (continued)

Costs or 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.

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

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.

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.

Adoption of GASB 84 – Effective July 1, 2018, the Research Foundation implemented GASB 84 Fiduciary Activities. The assets and liabilities for custodial funds are now presented on the statement of fiduciary net position and additions and deductions on the statement of changes in fiduciary net position. The effect on the financial statements as a result of this implementation included reducing prior fiscal year 2018 revenues and expenditures related to fiduciary activities by a net \$785,657, which is offset by an increase of \$785,657 in net position for the accumulative effect of past fiduciary activities, and reducing the prior fiscal year 2018 cash and due to University payable by \$1,523,676, respectively.

Subsequent Events – The Research Foundation evaluated all events and transactions that occurred from July 1, 2019 through October 10, 2019, the date the financial statements were available for issuance.

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

JUNE 30, 2019

Note 3—Investments and other investments

At June 30, 2019, 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	\$ 2,350,837	\$ 2,350,837	\$ -	\$ -	\$ -
Short-Term Corporate					
Bond Index Funds	4,194,692	-	4,190,497	4,195	-
Bonds	1,366,603	26,666	292,691	289,459	757,787
Equity Securities	894,078	No Maturity	-	-	-
Mutual Funds	4,663,963	No Maturity	-	-	-
Partnership Accounts	400,001	No Maturity	-	-	-
Pooled Investments:					
Money Market Funds	436,423	436,423	-	-	-
Bond Mutual Funds	3,758,306	-	3,758,306	-	-
Partnership Funds	5,439,614	No Maturity	-	-	-
Equity Mutual Funds	16,879,183	16,879,183	-	-	-
	<u>\$ 40,383,700</u>	<u>\$ 19,693,109</u>	<u>\$ 8,241,494</u>	<u>\$ 293,654</u>	<u>\$ 757,787</u>

Pooled investments represent the Research Foundation's interest in the University of South Florida Foundation's Agency Investment Program (the "Program"). The Program consists of an agency investment fund (the "Fund") which includes USF Foundation funds as well as funds invested by the Research Foundation and other University DSOs. 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 primary long-term investment strategy of the Program is to preserve the intergenerational equity of endowed gifts while providing a consistent source of funding for the University. The investment strategy is to earn a total rate of return that exceeds the spending rate, plus long-term inflation, plus the costs of managing the investment fund.

The Program pays a quarterly dividend based on the results of the Fund. Such dividends can either be withdrawn or reinvested. In addition, with 60-days' notice, the Research Foundation may withdraw either a portion of or its entire investment in the Program; however, the Research Foundation is limited to one withdrawal, other than any quarterly dividend, per calendar year. There were no unfunded commitments related to the Program as of June 30, 2019.

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

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

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

JUNE 30, 2019

Note 3—Investments and other investments (continued)

Custodial Credit Risk – Custodial credit risk is the risk of loss attributed to the magnitude of the Research Foundation’s investments held by outside parties. At June 30, 2019, the book balances of cash funds were \$7,126,505 and the bank balances were \$8,111,370. 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, 2019, the Research Foundation had bank balances of \$7,861,370 in excess of these insured limits.

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

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

At June 30, 2019, the Research Foundation has the following debt instrument quality ratings:

	<u>Fair Market Value</u>	<u>AAA</u>	<u>AA</u>	<u>A</u>	<u>Less Than A Rated</u>	<u>Not Rated</u>
Money Market Accounts	\$ 2,787,260	\$ -	\$ -	\$ -	\$ -	\$ 2,787,260
Short-Term Bond Index	4,194,692	59,565	508,816	1,716,468	1,909,843	-
Bonds	1,366,603	264,786	70,519	320,835	151,678	558,785
Mutual Funds	4,663,963	-	-	-	-	4,663,963
Bond Mutual Funds	3,758,306	298,066	121,226	295,137	1,393,553	1,650,324
	<u>\$ 16,770,824</u>	<u>\$ 622,417</u>	<u>\$ 700,561</u>	<u>\$ 2,332,440</u>	<u>\$ 3,455,074</u>	<u>\$ 9,660,332</u>

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

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

JUNE 30, 2019

Note 3—Investments and other investments (continued)

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

Level 2 – Inputs include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; inputs other than quoted prices that are observable for the asset or liability; inputs that are derived principally from or corroborated by observable market data by correlation or other means. If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

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

The asset's or liability's fair value measurement level within the fair value hierarchy, is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

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

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

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

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

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

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

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

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

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

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

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

JUNE 30, 2019

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, 2019.

	Total Fair Value	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
Investments by Fair Value Level				
Money Market Accounts	\$ 2,350,837	\$ 2,350,837	\$ -	\$ -
Short-Term Corporate Bond Index Funds	4,194,692	4,194,692	-	-
Bonds	1,366,603	-	1,366,603	-
Equity Securities	894,078	894,078	-	-
Mutual Funds	4,663,963	4,663,963	-	-
Partnership Accounts	400,001	-	-	400,001
Total Investments by Fair Value Level	\$ 13,870,174	\$ 12,103,570	\$ 1,366,603	\$ 400,001
Investments Measured at NAV				
Pooled Investments	<u>26,513,526</u>			
Total Investments Measured at NAV	<u>26,513,526</u>			
Total Investments	<u>\$ 40,383,700</u>			
Investment Derivative Instruments				
Interest Rate Swap Agreement	\$ 15,608			\$ 15,608
Total Investment Derivative Instruments	<u>\$ 15,608</u>			<u>\$ 15,608</u>

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

JUNE 30, 2019

Note 4—Accounts receivable

Non fiduciary accounts receivable consist of the following at June 30, 2019:

Royalty and license fees	\$ 801,580
Property leases	30,462
Other receivables	5,117
Allowance for doubtful accounts	(147,003)
	<u>\$ 690,156</u>

Note 5—Capital assets

Capital assets consist of the following at June 30, 2019:

	<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	181,920	604,123	(181,920)	604,123
Total capital assets not being depreciated	<u>8,921,553</u>	<u>604,123</u>	<u>(181,920)</u>	<u>9,343,756</u>
Capital assets being depreciated:				
Buildings	55,580,969	4,139,795	-	59,720,764
Equipment	3,357,918	6,021	(70,606)	3,293,333
Total capital assets being depreciated	<u>58,938,887</u>	<u>4,145,816</u>	<u>(70,606)</u>	<u>63,014,097</u>
Less accumulated depreciation for:				
Buildings	(24,072,718)	(2,386,382)	-	(26,459,100)
Equipment	(2,965,362)	(145,798)	65,967	(3,045,193)
Total accumulated depreciation	<u>(27,038,080)</u>	<u>(2,532,180)</u>	<u>65,967</u>	<u>(29,504,293)</u>
Total capital assets being depreciated, net	<u>31,900,807</u>	<u>1,613,636</u>	<u>(4,639)</u>	<u>33,509,804</u>
Total capital assets, net	<u>\$ 40,822,360</u>	<u>\$ 2,217,759</u>	<u>\$ (186,559)</u>	<u>\$ 42,853,560</u>

Note 6—Developer rights to Research Park

Other noncurrent assets include development rights for the 87.32 acre USF Research Park of Tampa Bay, formerly known as the University Technology Center, which the Research Foundation has accounted for as a prepaid lease of \$8,384,270 net of accumulated amortization of \$1,275,027. The intent of the Board of Trustees of the Internal Improvement Trust Fund, when granting these rights, was for a research and development park to be at the entrance to the University campus. While it is expected that the development rights will be renewed beyond the current 2081 expiration, the value of the rights are being amortized on a straight-line basis over 72 years. Annual amortization expense was \$115,912 for fiscal year 2019.

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

JUNE 30, 2019

Note 7—Notes receivable Seed Capital Accelerator Program

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

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

The Seed Capital Accelerator Program provides up to \$50,000 of loan funding to enable start-ups to quickly improve the odds of overcoming immediate obstacles to commercialization that would provide a measureable outcome and return on investment in the near term. The companies execute convertible promissory notes in an aggregate principal amount of up to \$50,000. The maturity date of each note is five years from initial closing date and the interest rate on each note is fixed at an annual rate equal to the Wall Street Journal prime rate plus 3% as of the date of the first advance. During fiscal year 2019, the Seed Capital Accelerator Program provided funding of \$25,000 to one company.

In fiscal year 2019, an additional reserve was recorded to reduce the net realizable value of the notes and interest receivable. Notes receivable are recorded at net realizable value of \$145,000 on the statement of net position, to include current portion of \$37,500 and noncurrent receivables of \$107,500.

The following is a schedule of maturities:

<u>Year</u>	Notes		
	<u>Receivable</u>	<u>Reserve</u>	<u>Net</u>
2020	\$ 415,000	\$ (377,500)	\$ 37,500
2021	205,000	(153,750)	51,250
2022	150,000	(112,500)	37,500
2023	50,000	(37,500)	12,500
2024	25,000	(18,750)	6,250
	<u>\$ 845,000</u>	<u>\$ (700,000)</u>	<u>\$ 145,000</u>

<u>Year</u>	Interest		
	<u>Receivable</u>	<u>Reserve</u>	<u>Net</u>
2020	\$ 62,882	\$ (52,144)	\$ 10,738
2021	19,960	(9,980)	9,980
2022	11,920	(5,960)	5,960
2023	2,651	(1,326)	1,325
2024	967	(483)	484
	<u>\$ 98,380</u>	<u>\$ (69,893)</u>	<u>\$ 28,487</u>

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

JUNE 30, 2019

Note 8—Accounts payable and accrued liabilities

Non fiduciary accounts payable and accrued liabilities consist of the following at June 30, 2019:

Vendors payable	\$ 1,031,606
Inventor royalties payable	686,600
Escrow payable	351,215
Interest payable	60,216
Other payables	145,170
	<u>\$ 2,274,807</u>

Note 9—Long-term debt

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

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

In 2013, the Research Foundation issued Series 2013-A Note to refund the outstanding Series 1999 Bond. The terms of the note include an interest rate of 67% of One-Month USD-London Interbank Offer Rate (“LIBOR”), to be payable monthly. The interest rate was 3.10% at June 30, 2019. Principal is payable annually. The Note matures December 1, 2019 and is secured by lease assignments in addition to the USF Foundation guarantee.

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

The Research Foundation has outstanding notes from direct borrowings related to business-type activities totaling \$17,155,000 at June 30, 2019. All outstanding notes from direct borrowings contain an event of default that changes the timing of repayment of outstanding amounts to become immediately due if the Research Foundation is unable to make payment or fails to perform any covenant, condition or agreement under the master loan or credit agreements.

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, 2019, \$1,120,834 of funds is on deposit with the bank in sinking fund accounts for payment of annual principal payments. These amounts have been reported in restricted cash on the statement of net position.

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

JUNE 30, 2019

Note 9—Long-term debt (continued)

Changes in long-term debt for the year ended June 30, 2019 are as follows:

	<u>June 30, 2018</u>	<u>Increases</u>	<u>Reductions</u>	<u>June 30, 2019</u>	<u>Amounts Due Within One Year</u>
Notes Payable:					
2013-A	\$ 2,000,000	\$ -	\$ (1,000,000)	\$ 1,000,000	\$ 1,000,000
2013-B	16,875,000	-	(720,000)	16,155,000	745,000
Total Notes Payable	<u>\$ 18,875,000</u>	<u>\$ -</u>	<u>\$ (1,720,000)</u>	<u>\$ 17,155,000</u>	<u>\$ 1,745,000</u>

The following is a schedule of maturities and total interest expense to include the interest rate swap agreement:

<u>Year</u>	<u>Maturities</u>	<u>Interest</u>
2020	\$ 1,745,000	\$ 564,765
2021	775,000	467,447
2022	805,000	441,927
2023	835,000	415,454
2024	870,000	387,880
2025 - 2029	4,890,000	1,513,495
2030 - 2034	5,910,000	616,523
2035	1,325,000	3,511
	<u>\$ 17,155,000</u>	<u>\$ 4,411,002</u>

Future obligations of interest expense, to include the interest rate swap agreement, are based on the fixed and variable rates in effect as of June 30, 2019, and may not be representative of actual rates in those later periods.

Total interest expense which includes interest for the notes and interest rate swap agreement, as further discussed in Note 10, was \$621,581 for fiscal year 2019.

Note 10—Derivative instruments

In 2001 and in 2006, the Research Foundation entered into interest rate swap agreements to limit the effects of changes in interest rates on its variable rate debt (see Note 9). In conjunction with the 2013 refunding of the 1999 and 2004 Bonds, and the reissuance of 2013 Series Notes with a new bank, an intercreditor agreement with the counterparty to the swap agreements was entered into. At June 30, 2019, only the 2001 swap agreement (Series 2013-A) remains in effect.

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

As interest rates have continued to decline since the Research Foundation entered into the swap agreement, the swap agreement has a negative fair value as of June 30, 2019 and as such, is presented as a noncurrent liability in the accompanying statement of net position. The fair value of the swap agreement is estimated taking into account current interest rates and the credit worthiness of the counterparties. The reported fair value is calculated using the marked-to-market method by an independent third party.

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

JUNE 30, 2019

Note 10—Derivative instruments (continued)

The fair value and key terms of the Research Foundation’s swap agreement at June 30, 2019 are as follows:

<u>Notes</u>	<u>Notional Amount</u>	<u>Effective Date</u>	<u>Maturity Date</u>	<u>Fixed Rate</u>	<u>Estimated Fair Value</u>
Series 2013-A	\$ 2,000,000	06/01/01	12/01/19	4.560%	\$ (15,608)

Credit Risk – Because the swap has a negative fair value, the Research Foundation is exposed to the credit risk of Bank of America, NA in the amount of the swap’s fair value. Bank of America has ratings of Aa-2 (long-term) and P-1 (short-term) by Moody’s Investors Services, and A+ (long-term) and A-1 (short-term) by Standard & Poor’s.

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

Total interest expense as disclosed in Note 9 includes interest under terms of the swap agreement of \$42,887 for fiscal year 2019.

The following is a schedule of expected future interest payments required under the swap agreement as of June 30, 2019:

<u>Year</u>	<u>Amount</u>
2020	\$ 19,000

Note 11—Capital lease obligation

The Research Foundation has entered into a capital lease agreement with another DSO of the University, under which the building will become the property of the Research Foundation when all terms of the lease agreement are met.

The following is a schedule of future minimum lease payments under the capital lease together with the present value of the minimum lease payments as of June 30, 2019:

<u>Year</u>	<u>Amount</u>
2020	\$ 426,094
2021	375,969
2022	375,969
2023	375,969
2024	2,554,305
Total minimum lease payments	4,108,306
Less amount representing interest	(602,700)
Present value of minimum lease payments under capital leases	3,505,606
Less current maturities	(281,018)
Long-term portion	\$ 3,224,588

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

JUNE 30, 2019

Note 11—Capital lease obligation (continued)

A capital asset has been recorded in the amount of \$3,505,606. The building is subleased to a nonrelated party. The above lease commitment will be offset by \$1,817,768 in sublease rental income through the year ending June 30, 2024. Amortization of the leased building is included with depreciation expense.

Note 12—Property rental revenues

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

Investments in assets subject to operating leases are as follows at June 30, 2019:

Buildings, at cost	\$ 55,346,758
Accumulated depreciation	<u>(25,947,624)</u>
Net investments in assets subject to operating leases	<u><u>\$ 29,399,134</u></u>

Depreciation expense related to the buildings leased to other parties was \$2,312,212 for fiscal year 2019.

Future minimum lease payments expected to be received under noncancelable operating leases as of June 30, 2019 are as follows:

<u>Year</u>	<u>Total Amount</u>	<u>Related Party</u>
2020	\$ 8,765,119	\$ 7,926,333
2021	8,421,869	7,760,346
2022	7,185,741	6,809,651
2023	6,922,949	6,546,859
2024	5,468,868	5,155,460
Thereafter	<u>48,096,991</u>	<u>48,096,991</u>
	<u><u>\$ 84,861,537</u></u>	<u><u>\$ 82,295,640</u></u>

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

JUNE 30, 2019

Note 13—Operating lease commitment

The Research Foundation entered into a five-year lease commitment of office space. The lease expires in fiscal year 2024.

Future minimum lease payments expected to be paid under the noncancelable operating lease as of June 30, 2019 are as follows:

<u>Year</u>	<u>Amount</u>
2020	\$ 631,527
2021	644,215
2022	656,451
2023	668,992
2024	111,849
	<u>\$ 2,713,034</u>

Note 14—Related party transactions

The University leases a building from the Research Foundation, under a master lease agreement through 2036 or the expiration of the long-term debt, if earlier (see Note 9). Other research laboratories and office space are also leased to the University under operating leases which expire through fiscal year 2026. Total rent revenues from the University were \$7,864,638 for fiscal year 2019.

The Research Foundation invoices intellectual property licensees for reimbursement of patent costs that are due to the University. Total amounts invoiced in fiscal year 2019 of \$605,765 for patent costs recovery are not reflected in the accompanying statement of revenues, expenses, and changes in net position. Patent costs recovered from intellectual property cash receipts are remitted to the University, which totaled \$514,612 in fiscal year 2019. A net liability of \$75,313 for accrued patent costs due to the University less outstanding receivables from licensees for reimbursement of costs, are included in the due to University of South Florida payable in the statement of net position.

In accordance with agreements, the Research Foundation has administrative responsibility for post-award management of certain non-clinical contracts and grants on behalf of the University. Post-award management includes processing sponsor invoicing and related expenditures for those contracts and grants. In fiscal year 2019, the Research Foundation processed \$673,379 of grant expenditures, of which \$314,361 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. When permitted by the agreement, an administrative fee is charged for processing expenditures, and is recognized as administrative fee revenue. The Research Foundation recognized administrative fee revenue in the amount of \$83,433 for these services in fiscal year 2019. The custodial fund balance for the University grant agreements of \$411,250 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 business expenditures. Graphicstudio's net position of \$229,598 at June 30, 2019 is included in the statement of fiduciary net position.

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

JUNE 30, 2019

Note 14—Related party transactions (continued)

On behalf of the University, the Research Foundation manages the fiscal operations of the Incubator program. During fiscal year 2019, the Research Foundation processed tenant rents and sponsor support of \$1,272,314 for the Incubator program. In addition to expenditures processed by the University, program expenditures of \$227,291 were also processed through the Research Foundation. An administrative fee is charged for processing transactions and is recognized as administrative fee revenue. The Research Foundation recognized administrative fee revenue in the amount of \$69,430 for these services in fiscal year 2019. The net position restricted for the USF Incubator Program of \$1,045,023 at June 30, 2019 is included in the statement of fiduciary net position.

Included in the due to University of South Florida payable in the statement of net position as of June 30, 2019 are Research funds held on behalf of University faculty, department, and colleges in the amount of \$4,479,415, that will be utilized to support their research and education activities. The Research Foundation distributes royalties from intellectual property net revenue to these research funds. During fiscal year 2019, the Research Foundation recognized royalty distribution expenses of \$430,778 and \$290,087, respectively, to University departments and colleges' research funds, of which \$325,981 and \$227,943, respectively, were distributed. Accrued royalties payable of \$393,933 are included in the due to University payable in the statement of net position.

Under agreements with the University, the Research Foundation is engaged to manage renovations of research facilities to support University research within the USF Research Park. At June 30, 2019, funding received in excess of costs incurred of \$1,421,363 is included in the due to University payable in the statement of net position.

The President of the Research Foundation is the co-founder and member of the board for two companies that each received a loan of \$50,000 in fiscal year 2014 as part of the Seed Capital Accelerator Program. The terms of the notes were consistent with the Seed Capital Accelerator Program as disclosed in Note 7. The notes matured in fiscal year 2019, but remain outstanding at June 30, 2019.

All personnel of the Research Foundation are employees of the University with employee benefits and compensated absences accounted for on the University's books. The University tracks, administers, and reports all payroll and fringe benefit costs for Research Foundation personnel, which are then reimbursed to the University by the Research Foundation. In fiscal year 2019, salary and fringe benefit costs were \$1,289,740.

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

YEAR ENDED JUNE 30, 2019

	Program Services	Management and General	Total
Depreciation Expense	\$ 2,532,180	\$ -	\$ 2,532,180
Royalty Expense	2,146,540	-	2,146,540
Repairs and Maintenance	1,354,505	20,610	1,375,115
Utilities	1,370,798	-	1,370,798
Salary and Wages	495,262	551,333	1,046,595
Rental Expense	516,668	-	516,668
Bad Debt Expense	446,929	-	446,929
Technology Costs	365,889	-	365,889
Fringe Benefits	166,410	181,117	347,527
Insurance	250,324	10,752	261,076
Independent Contractors	178,005	10,415	188,420
Materials and Supplies	146,791	20,097	166,888
Amortization Expense	115,912	-	115,912
Professional Fees	7,223	68,430	75,653
Real Estate Tax	45,072	-	45,072
Telephone	17,084	11,064	28,148
Grant Administrative Fees	13,105	-	13,105
Subscriptions and Memberships	3,476	3,200	6,676
Travel	3,552	329	3,881
Bank Fees	2,109	1,573	3,682
Postage and Freight	-	1,644	1,644
Participant Stipends and Tuition	1,500	-	1,500
Printing Costs	-	1,407	1,407
Total Operating Expenses	\$ 10,179,334	\$ 881,971	\$ 11,061,305

**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
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 business-type activities and the aggregate remaining fund information of the University of South Florida Research Foundation, Inc. (the “Research Foundation”), as of and for the year ended June 30, 2019, 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 10, 2019. Our report also recognizes that the Research Foundation implemented a new accounting standard effective July 1, 2018.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Research Foundation’s internal control over financial reporting (“internal control”) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions 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.

Cherry Bekant LLP

Tampa, Florida
October 10, 2019