STEADMAN PHILIPPON RESEARCH INSTITUTE

Consolidated Financial Statements
and
Independent Auditors' Report
December 31, 2016 and 2015

EKS&H

STEADMAN PHILIPPON RESEARCH INSTITUTE

Table of Contents

EKS&H

8181 East Tufts Avenue, Suite 600
Denver, Colorado 80237-2521
P: 303-740-9400
F: 303-740-9009
www.EKSH.com

EKS&H LLLP

INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Steadman Philippon Research Institute and Subsidiary
Vail, Colorado

We have audited the accompanying consolidated financial statements of Steadman Philippon Research Institute and Subsidiary, which are comprised of the consolidated statements of financial position as of December 31, 2016 and 2015, and the related consolidated statements of activities, functional expenses, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

AUDITORS' RESPONSIBILITY

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the consolidated 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Steadman Philippon Research Institute and Subsidiary as of December 31, 2016 and 2015, and the changes in their net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

EKS+H LLLP

EKS&H LLLP

June 27, 2017
Denver, Colorado

STEADMAN PHILIPPON RESEARCH INSTITUTE

Consolidated Statements of Financial Position

	December 31, 2016	December 31, 2015
Assets		
Current assets		
Cash and cash equivalents	$ 2,370,072	$ 97,838
Accounts receivable	96,157	33,360
Accounts receivable, related party	69,224	50,434
Contributions receivable, current portion	1,195,000	1,095,000
Prepaid expenses and other assets	100,400	127,093
Investments	272,384	2,149,642
Total current assets	4,103,237	3,553,367
Contributions receivable, less current portion	7,459,888	8,162,022
Property and equipment, net	842,740	365,343
Investments, other	227,050	227,050
Deferred tax asset	-	2,651
Total assets	$ 12,632,915	$ 12,310,433
Liabilities and Net Assets		
Current liabilities		
Accounts payable	$ 130,552	$ 130,238
Accrued expenses	424,386	121,847
Line-of-credit	1,273,800	1,425,800
Deferred revenue	10,000	-
Deferred tax liability	10,812	-
Current portion of note payable	129,016	-
Total current liabilities	1,978,566	1,677,885
Long-term liabilities		
Note payable, less current portion	486,008	-
Total liabilities	2,464,574	1,677,885
Commitments		
Net assets		
Unrestricted	1,513,453	1,135,289
Temporarily restricted	8,654,888	9,497,259
Total net assets	10,168,341	10,632,548
Total liabilities and net assets	$ 12,632,915	$ 12,310,433

See notes to consolidated financial statements.

STEADMAN PHILIPPON RESEARCH INSTITUTE

Consolidated Statements of Activities

	For the Years Ended December 31, 2016 Unrestricted	December 31, 2016 Temporarily Restricted	December 31, 2016 Total	December 31, 2015 Unrestricted	December 31, 2015 Temporarily Restricted	December 31, 2015 Total
Revenues, gains, and other support						
Grants and corporate partners	$ 4,391,045	$ 1,206,807	$ 5,597,852	$ 1,269,599	$ 9,728,728	$ 10,998,327
Contributions	1,371,581	592,810	1,964,391	1,271,764	334,422	1,606,186
Fundraising events	210,002	-	210,002	-	-	-
MRI income	723,000	-	723,000	723,000	-	723,000
In-kind contributions	131,198	-	131,198	297,955	-	297,955
Other income	2,924	-	2,924	1,740	-	1,740
	6,829,750	1,799,617	8,629,367	3,564,058	10,063,150	13,627,208
Net assets released from restrictions	2,641,988	(2,641,988)	-	1,301,711	(1,301,711)	-
Total revenues, gains, and other support	9,471,738	(842,371)	8,629,367	4,865,769	8,761,439	13,627,208
Operating expenses						
Center for Regenerative Sports Medicine	2,584,495	-	2,584,495	1,610,875	-	1,610,875
Department of BioMedical Engineering	979,484	-	979,484	1,565,132	-	1,565,132
Surgical Skills Laboratory	490,395	-	490,395	922,302	-	922,302
Center for Outcomes-Based Orthopaedic Research	968,365	-	968,365	774,737	-	774,737
Education department	598,217	-	598,217	558,624	-	558,624
Department of Technology & Communications	283,632	-	283,632	257,054	-	257,054
Imaging research	354,919	-	354,919	551,116	-	551,116
General and administrative	1,206,607	-	1,206,607	1,278,769	-	1,278,769
Development	1,516,501	-	1,516,501	1,697,430	-	1,697,430
Total operating expenses	8,982,615	-	8,982,615	9,216,039	-	9,216,039
Other expenses						
Investment loss	9,993	-	9,993	237,368	-	237,368
Interest expense	70,520	-	70,520	40,235	-	40,235
Total other expenses	80,513	-	80,513	277,603	-	277,603
Provision for income tax expense	(30,446)	-	(30,446)	(41,144)	-	(41,144)
Change in net assets	378,164	(842,371)	(464,207)	(4,669,017)	8,761,439	4,092,422
Net assets at beginning of year	1,135,289	9,497,259	10,632,548	5,804,306	735,820	6,540,126
Net assets at end of year	$ 1,513,453	$ 8,654,888	$ 10,168,341	$ 1,135,289	$ 9,497,259	$ 10,632,548

See notes to consolidated financial statements.

STEADMAN PHILIPPON RESEARCH INSTITUTE

Consolidated Statement of Functional Expenses
For the Year Ended December 31, 2016

	Program Services								Support Services		
	Center for Regenerative Sports Medicine	Department of BioMedical Engineering	Surgical Skills Laboratory	Center for Outcomes-Based Orthopaedic Research	Education Department	Department of Technology & Communications	Imaging Research	Total Program Services	General and Administrative	Development	Total
Salaries and benefits	$ 786,045	$ 484,482	$ 60,429	$ 777,131	$ 397,594	$ 209,603	$ 170,407	$ 2,885,691	$ 888,582	$ 286,716	$ 4,060,989
Consulting and contract labor	692,117	68,501	450	12,950	360	-	85,787	860,165	111,530	174,777	1,146,472
Supplies (office, computer, lab)	190,080	237,786	212,338	36,561	8,070	8,904	5,298	699,037	12,990	31,482	743,509
Events and fundraising	-	-	-	-	-	-	-	-	-	189,483	189,483
Printing	445	20,065	356	4,020	1,550	959	755	28,150	1,304	77,024	106,478
Maintenance and supplies	24,166	8,953	22,018	6,037	4,570	4,664	4,480	74,888	5,554	601	81,043
Rent and leases	310,456	13,485	22,835	43,422	5,131	10,179	9,177	414,685	4,106	4,730	423,521
Telephone and utilities	58,310	17,159	33,027	16,287	6,506	14,070	11,662	157,021	22,541	8,772	188,334
Travel	134,705	22,181	150	21,713	32,274	820	10,441	222,284	442	7,500	230,226
Legal and accounting	102,453	12,879	1,436	41,525	31,669	3,663	4,768	198,393	117,270	30,346	346,009
Fellows	-	-	-	-	37,119	-	-	37,119	-	-	37,119
Education meetings/lectures	-	-	-	-	38,462	-	-	38,462	-	-	38,462
Direct mail/planned giving	-	-	-	-	-	-	-	-	-	133,388	133,388
Meals and entertainment	18,373	948	46	1,244	3,941	47	245	24,844	4,057	1,225	30,126
Gifts	365	-	-	-	-	-	-	365	176	635	1,176
Postage	5,376	1,675	447	2,297	1,197	598	(565)	11,025	1,145	2,784	14,954
Insurance	212	1,411	212	1,975	917	564	564	5,855	26,249	282	32,386
Fees, dues, and subscriptions	8,359	3,231	-	2,437	28,857	-	2,203	45,087	1,169	357	46,613
Bank/credit card fees	395	-	(506)	-	-	-	-	(111)	1,270	6,850	8,009
Meetings (Board and SAC)	51,345	-	-	-	-	-	-	51,345	7,701	-	59,046
Scientific summit	184,076	-	-	-	-	-	-	184,076	-	-	184,076
Research grant	5,220	-	-	-	-	-	-	5,220	-	-	5,220
Marketing	-	4,170	-	-	-	-	-	4,170	-	557,784	561,954
	2,572,498	896,926	353,238	967,599	598,217	254,071	305,222	5,947,771	1,206,086	1,514,736	8,668,593
Depreciation and amortization	11,997	82,558	137,157	766	-	29,561	49,697	311,736	521	1,765	314,022
Total operating expenses	2,584,495	979,484	490,395	968,365	598,217	283,632	354,919	6,259,507	1,206,607	1,516,501	8,982,615
For management reporting:											
Allocation of overhead to programs	771,734	268,965	105,956	290,120	179,412	76,181	91,552	1,783,920	(642,879)	(1,141,041)	-
Total including overhead allocation	$ 3,356,229	$ 1,248,449	$ 596,351	$ 1,258,485	$ 777,629	$ 359,813	$ 446,471	$ 8,043,427	$ 563,728	$ 375,460	$ 8,982,615

See notes to consolidated financial statements.

STEADMAN PHILIPPON RESEARCH INSTITUTE

Consolidated Statement of Functional Expenses
For the Year Ended December 31, 2015

	Program Services								Support Services		
	Center for Regenerative Sports Medicine	Department of BioMedical Engineering	Surgical Skills Laboratory	Center for Outcomes-Based Orthopaedic Research	Education Department	Department of Technology & Communications	Imaging Research	Total Program Services	General and Administrative	Development	Total
Salaries and benefits	$ 477,003	$ 424,553	$ 73,955	$ 650,008	$ 378,145	$ 196,250	$ 190,732	$ 2,390,646	$ 1,115,888	$ 279,125	$ 3,785,659
Consulting and contract labor	417,560	11,193	150	1,400	2,540	1,075	77,212	511,130	1,520	441,875	954,525
Supplies (office, computer, lab)	132,878	670,346	223,438	18,644	734	4,437	3,963	1,054,440	6,852	5,345	1,066,637
Events and fundraising	-	-	-	-	-	-	-	-	-	111,760	111,760
Printing	592	9,843	265	3,471	896	544	545	16,156	1,225	93,437	110,818
Maintenance and supplies	8,326	13,095	17,613	4,816	10,448	4,598	4,272	63,168	7,356	12,097	82,621
Rent and leases	147,291	54,570	28,322	40,587	5,306	5,193	7,638	288,907	(917)	19,557	307,547
Telephone and utilities	12,485	69,485	34,660	8,649	6,113	7,154	8,672	147,218	13,377	3,955	164,550
Travel	158,803	11,264	68	13,068	30,236	705	11,914	226,058	22,771	733	249,562
Legal and accounting	106,927	17,317	1,211	13,697	24,747	2,984	6,236	173,119	30,573	14,307	217,999
Fellows	-	-	-	-	22,908	-	925	23,833	-	-	23,833
Education meetings/lectures	-	-	-	-	41,731	-	-	41,731	-	-	41,731
Direct mail/planned giving	-	-	-	-	-	-	-	-	-	120,965	120,965
Meals and entertainment	13,364	6,576	1,072	3,647	16,651	1,019	3,197	45,526	17,760	7,357	70,643
Gifts	314	1,077	180	1,946	1,257	359	359	5,492	1,236	10,133	16,861
Postage	1,473	856	507	1,770	1,163	201	(577)	5,393	237	3,436	9,066
Insurance	140	1,131	166	1,530	658	451	373	4,449	27,202	308	31,959
Fees, dues, and subscriptions	3,950	2,395	-	2,053	14,607	735	925	24,665	2,372	357	27,394
Bank/credit card fees	-	-	-	-	-	-	500	500	175	6,670	7,345
Meetings (Board and SAC)	54,801	-	-	-	-	-	-	54,801	29,326	-	84,127
Scientific summit	68,071	-	-	-	-	-	-	68,071	-	-	68,071
Research grant	30	-	-	-	-	-	-	30	-	-	30
Marketing	-	2,000	-	273	90	-	-	2,363	-	564,718	567,081
	1,604,008	1,295,701	381,607	765,559	558,230	225,705	316,886	5,147,696	1,276,953	1,696,135	8,120,784
Depreciation and amortization	6,867	269,431	540,695	9,178	394	31,349	234,230	1,092,144	1,816	1,295	1,095,255
Total operating expenses	1,610,875	1,565,132	922,302	774,737	558,624	257,054	551,116	6,239,840	1,278,769	1,697,430	9,216,039
For management reporting:											
Allocation of overhead to programs	481,202	388,710	114,482	229,668	167,469	67,712	95,066	1,544,309	(663,287)	(881,022)	-
Total including overhead allocation	$ 2,092,077	$ 1,953,842	$ 1,036,784	$ 1,004,405	$ 726,093	$ 324,766	$ 646,182	$ 7,784,149	$ 615,482	$ 816,408	$ 9,216,039

See notes to consolidated financial statements.

STEADMAN PHILIPPON RESEARCH INSTITUTE

Consolidated Statements of Cash Flows

	For the Years Ended December 31, 2016	2015
Cash flows from operating activities		
Change in net assets	$ (464,207)	$ 4,092,422
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities		
Depreciation and amortization expense	314,022	1,095,255
Net loss on investments	9,993	229,587
Donated stock	-	(330,698)
Deferred taxes	13,463	34,229
Changes in assets and liabilities		
Accounts receivable	(81,587)	(64,381)
Contributions receivable	602,134	(9,061,645)
Prepaid expenses and other assets	26,693	58,868
Inventory	-	37,548
Accounts payable	314	(190,789)
Accrued expenses	302,539	(37,361)
Deferred revenue	10,000	-
	1,197,571	(8,229,387)
Net cash provided by (used in) operating activities	733,364	(4,136,965)
Cash flows from investing activities		
Proceeds from sale of investments	1,867,265	2,989,865
Purchases of property and equipment	(103,706)	(61,043)
Net cash provided by investing activities	1,763,559	2,928,822
Cash flows from financing activities		
Payments on note payable	(72,689)	-
Net (payments) borrowings on line-of-credit	(152,000)	797,000
Net cash (used in) provided by financing activities	(224,689)	797,000
Net increase (decrease) in cash and cash equivalents	2,272,234	(411,143)
Cash and cash equivalents at beginning of year	97,838	508,981
Cash and cash equivalents at end of year	$ 2,370,072	$ 97,838

Supplemental disclosure of cash flow information:

Cash paid for interest was $70,520 and $40,235 for the years ended December 31, 2016 and 2015, respectively.

Supplemental disclosure of non-cash activity:

During the year ended December 31, 2016, the Institute financed $687,713 of equipment additions through a note payable.

See notes to consolidated financial statements.

Note 1 - Organization and Summary of Significant Accounting Policies

Organization

The Steadman Philippon Research Institute ("SPRI"), a non-profit organization, was founded in 1988 and incorporated in the state of Colorado on February 22, 1999. SPRI is located in Vail, Colorado, and its mission is building on its legacy of excellence in orthopaedic sports medicine. SPRI is unlocking the secrets of healing, finding cures, and enhancing lives through global leadership in regenerative medicine, scientific research, innovation, and education. SPRI is fortunate to draw upon the talents of respected members of local, national, and international communities with business, medical, and scientific backgrounds who all share a common interest in keeping people active. SPRI is recognized globally for its pioneering research in osteoarthritis, healing, surgery, and injury prevention and rehabilitation. Since 1993, SPRI's database (one of the largest in existence) has been collecting the patient information that has led to significant treatment advances in these areas.

SPRI's Center for Regenerative Sports Medicine has a primary focus to identify, characterize, and clinically translate the use of adult stem cells in the treatment of a variety of musculoskeletal tissues after injuries, disease, and aging. The Center for Regenerative Sports Medicine is comprised of an internationally diverse group of investigators that apply a large battery of techniques to isolate, characterize, and clinically model the use of muscle-derived cells.

SPRI's Department of BioMedical Engineering is a multidisciplinary laboratory that applies quantitative, analytical, and integrative methods to the field of orthopaedic medicine. The multitalented research staff integrates clinical care, research, and education with the resources of world-renowned medical doctors in order to improve the treatment of musculoskeletal diseases. This focused approach is designed to maintain and enhance athletic performance, health, and quality of life for professional, semi-professional, collegiate, high school, and recreationally active individuals through an emphasis of bench-bedside research. The programs provided by the Department of BioMedical Engineering are unique and diverse and they encompass a complete range of services for the physically active or those wishing to return to an active lifestyle after injury.

SPRI's outcomes-based orthopaedic research ("outcomes research") has been defined as the study of the end results of medical treatment, which is intended to provide scientific evidence to support patient and physician decisions regarding medical treatment. SPRI's outcomes research is based on physician/patient assessment of improvement in function, quality of life, and patient satisfaction. Outcomes research provides a tool to link the patient's perspective to the effectiveness of health treatment. This allows for increased participation by patients in the decision-making process regarding the kind of care they desire. The goal in outcomes research is to learn from patients and validate treatment protocols in an effort to improve the quality of health care for every patient.

SPRI has agreements with several corporations that sponsor SPRI's research. This research is for the general use of and publication by SPRI. These agreements are recorded as income in the year the research is performed and payment is received.

SPRI created SPRI Leasing Corporation ("Subsidiary"), a wholly owned subsidiary, in order to hold the assets, liabilities, revenues, and expenses derived from SPRI's MRI scanner.

Note 1 - Organization and Summary of Significant Accounting Policies (continued)

Principles of Consolidation

The reporting entity referred to as Steadman Philippon Research Institute and Subsidiary (collectively, the "Institute") includes the accounts of SPRI and SPRI Leasing Corporation. All intercompany accounts and transactions have been eliminated in consolidation.

Basis of Presentation

The Institute reports information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

> Unrestricted amounts are those currently available at the discretion of the Board of Directors ("Board") for use in the Institute's operations, fundraising, and certain programs.
>
> Temporarily restricted amounts are monies restricted by donors specifically for certain purposes or programs; these monies are available for use by the Institute for the restricted purpose.
>
> Permanently restricted amounts are assets that must be maintained permanently by the Institute as required by the donor, but the Institute is permitted to use or expend part or all of any income derived from those assets. As of December 31, 2016 and 2015, the Institute did not have any permanently restricted amounts.

Cash and Cash Equivalents

The Institute considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents, unless held for reinvestment as part of the investment portfolio or otherwise encumbered.

Accounts and Contributions Receivable

Accounts and contributions receivable represent amounts due from individuals and organizations in support of the Institute's programs. Management considers all amounts collectible; therefore, no allowance has been recorded as of December 31, 2016 and 2015.

Unconditional gifts expected to be collected within one year are reported at their net realizable value. Unconditional gifts expected to be collected in future years are reported at the present value of estimated future cash flows. The resulting discount is amortized using the effective interest method and is reported as contribution revenue.

Investments

The Institute reports investments in equity securities with readily determinable fair values and all investments in debt securities at their fair values with unrealized gains and losses included in the consolidated statements of activities.

Note 1 - Organization and Summary of Significant Accounting Policies (continued)

Investments (continued)

The Institute holds alternative investments, which are not readily marketable and are carried at fair value as provided by the investment managers. The Institute reviews and evaluates the value provided by the investment managers and agrees with the valuation methods and assumptions used in determining the fair value of the alternative investments. Those estimated fair values may differ significantly from the values that would have been used had a ready market for these securities existed.

Investment return includes dividends, interest, and other investment income; realized and unrealized gains and losses on investments carried at fair value; and realized gains and losses on other investments. Investment returns are reflected in the consolidated statements of activities as unrestricted, temporarily restricted, or permanently restricted based upon the existence and nature of any donor or legally imposed restrictions.

Property and Equipment

Leasehold improvements and equipment purchased by the Institute are recorded at cost. Donated fixed assets are capitalized at fair value at the date of donation. Depreciation is provided on the straight-line method based upon the estimated useful lives of the assets, which range from three to seven years. Leasehold improvements are amortized over the shorter of the lease term plus renewal options or the estimated useful lives of the improvements.

Other Investment

The Institute holds contributed real estate, which was recorded at estimated fair value at the date of donation. The investment is assessed for impairment if events and circumstances warrant such a review. No such impairment was recognized during 2016 or 2015.

Contributions

Gifts of cash and other assets received without donor stipulations are reported as unrestricted support. Gifts received with a donor stipulation that limits their use are reported as temporarily or permanently restricted support. When a donor-stipulated time restriction ends or a purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statements of activities as net assets released from restrictions.

Gifts of land, buildings, equipment, and other long-lived assets are reported as unrestricted support unless explicit donor stipulations specify how such assets must be used, in which case the gifts are reported as temporarily or permanently restricted support. Absent explicit donor stipulations for the time that long-lived assets must be held, expirations of restrictions resulting in reclassification of temporarily restricted net assets as unrestricted net assets are reported when the long-lived assets are placed in service.

Note 1 - Organization and Summary of Significant Accounting Policies (continued)

Revenue Recognition

MRI and other income are recognized at the time the services are provided.

Functional Expenses

Expenses incurred directly for a program service are charged to such program. Allocations of certain overhead costs are also allocated to programs on a pro rata basis of total space occupied by each service or by headcount.

Income Taxes

SPRI is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code ("IRC"). SPRI is not a private foundation within the meaning of Section 509(a) of the IRC.

The Subsidiary is a for-profit corporation that is required to file a corporate income tax return for its operations and recognizes deferred tax assets and liabilities based upon differences between its basis of assets for tax and financial reporting purposes.

The Institute applies a more-likely-than-not measurement methodology to reflect the financial statement impact of uncertain tax positions taken or expected to be taken in a tax return. After evaluating the tax positions taken, none are considered to be uncertain; therefore, no amounts have been recognized as of December 31, 2016 and 2015. If incurred, interest and penalties associated with tax positions are recorded in the period assessed as general and administrative expense. No interest or penalties have been assessed for the years ended December 31, 2016 or 2015.

Use of Estimates

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

Recently Adopted Accounting Pronouncements

In May 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2015-07, *Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent).* The amendment applies to reporting entities that elect to measure the fair value of an investment using the net asset value ("NAV") per share (or its equivalent) practical expedient. The amendment removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the NAV per share practical expedient.

Note 1 - Organization and Summary of Significant Accounting Policies (continued)

Recently Adopted Accounting Pronouncements (continued)

The amendment also removes the requirement to make certain disclosures for all investments that are eligible to be measured at fair value using the NAV per share practical expedient. Rather, those disclosures are limited to investments for which the entity has elected to measure the fair value using that practical expedient. The Institute adopted the new amendment for the year ended December 31, 2016 and adjusted the financial statement disclosures for all periods presented.

The adoption of this new accounting pronouncement did not have a material impact on the Institute's consolidated financial statements.

Recently Issued Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers*, which amended revenue recognition guidance to clarify the principles for recognizing revenue from contracts with customers. The guidance requires an entity to recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance also requires expanded disclosures relating to the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Additionally, qualitative and quantitative disclosures are required about customer contracts, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. ASU No. 2014-09 is effective for annual reporting in fiscal years that begin after December 15, 2017.

In February 2016, the FASB issued ASU No. 2016-02, *Leases*, which amended the FASB Accounting Standards Codification ("ASC") and created Topic 842, *Leases*. The new topic supersedes ASC Topic 840, *Leases*, and increases transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and requires disclosures of key information about leasing arrangements. The guidance is effective for reporting periods beginning after December 15, 2019. ASU No. 2016-02 mandates a modified retrospective transition method.

Note 1 - Organization and Summary of Significant Accounting Policies (continued)

Recently Issued Accounting Pronouncements (continued)

In August 2016, the FASB issued ASU No. 2016-14, *Not-For-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. The amendment reduces the classes of net assets to net assets with donor restrictions and net assets without donor restrictions; removes the reconciliation of cash flows to the indirect method if using the direct method; requires the reporting of investment returns, net of expenses, with no disclosure of netted expenses required; requires the use, in the absence of explicit donor stipulations, of the placed-in-service approach for reporting expirations of restrictions on cash or other asset donations; and requires disclosure of expenses by both their natural and functional classification on the face of the statement of activities, as a separate statement, or in the notes to the financial statements. In addition, the amendment provides enhanced disclosures on amounts and purposes of board designations and appropriations, composition of net assets with donor restrictions, discussion of liquidity for the year following year-end, discussion of liquidity of financial assets at year-end, methodology used to allocate costs between program and support functions, and underwater endowment funds. The amendment is effective for all fiscal years beginning after December 15, 2017 with early adoption allowed. Entities should apply the amendment in this update retrospectively to all periods presented.

The Institute is currently evaluating the new standards and their impact on the Institute's consolidated financial statements.

Subsequent Events

The Institute has evaluated all subsequent events through the auditors' report date, which is the date the consolidated financial statements were available to be issued.

Note 2 - Fair Value Measurements and Investments

The Institute values its financial assets and liabilities based on 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. In order to increase consistency and comparability in fair value measurements, the following fair value hierarchy prioritizes observable inputs used to measure fair value into three broad levels, which are described below:

Level 1: Quoted prices in active markets for identical assets or liabilities that are accessible at the measurement date. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2: Other than quoted prices that are observable for the asset or liability, either directly or indirectly.

Level 3: Unobservable inputs where little or no market data is available, which requires the reporting entity to develop its own assumptions.

Note 2 - Fair Value Measurements and Investments (continued)

In determining fair value, the Institute utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible, as well as considers counterparty credit risk in its assessment of fair value. These classifications (Levels 1, 2, and 3) are intended to reflect the observability of inputs used in the valuation of investments and are not necessarily an indication of risk or liquidity.

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

> M*utual funds*: Valued at the closing price reported on the active market on which the individual securities are traded.

There have been no changes to valuation methodologies during the years ended December 31, 2016 and 2015.

No financial assets at December 31, 2016 were subject to fair value classification disclosure.

Financial assets carried at fair value as of December 31, 2015 are classified in the table below in one of the three categories described above.

Description	Level 1	Level 2	Level 3	Total
Equity mutual funds	$ 234,982	$ -	$ -	$ 234,982

Investments consist of the following:

	December 31, 2016	December 31, 2015
Assets classified in the fair value table	$ -	$ 234,982
Investments reported at NAV	234,735	1,826,950
Distributions receivable	37,649	-
Money market funds	-	87,710
	$ 272,384	$ 2,149,642

Investments in certain entities that calculate NAV per share are as follows:

Fund Description	December 31, 2016 Fair Value	December 31, 2015 Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Absolute Return Funds	$ 234,735	$ 1,826,950	None	Quarterly to Annually	45 to 90 Days

Note 2 - Fair Value Measurements and Investments (continued)

The Absolute Return Funds employ a strategy to achieve consistent positive, absolute returns with low volatility primarily by seeking to exploit pricing inefficiencies in equity and debt securities and by using a traditional hedge fund approach. The fair value of the investments has been calculated using the NAV per share of the investments.

Investment return consists of the following:

	For the Years Ended December 31, 2016	For the Years Ended December 31, 2015
Net realized and unrealized losses	$ (9,993)	$ (229,587)
Fees	-	(7,781)
Total return on investments	$ (9,993)	$ (237,368)

Note 3 - Contributions

Contributions receivable consist of the following:

	December 31, 2016	December 31, 2015
Due in less than one year	$ 1,195,000	$ 1,095,000
Due in one to five years	5,285,000	5,110,000
Due in over five years	3,000,000	4,000,000
	9,480,000	10,205,000
Less unamortized discount	(825,112)	(947,978)
	$ 8,654,888	$ 9,257,022

The discount rate used was 2.45% and 2.27% for 2016 and 2015, respectively.

In December 2015, the Institute entered into an agreement that guaranteed a minimum contribution of $1,000,000 per year from 2016 through 2025. The contribution has been recorded as a contribution receivable and is included as a temporarily restricted net asset. In addition, there are certain conditional requirements in the agreement that allow the Institute to receive up to $4,300,000 per year.

Note 4 - Property and Equipment

The Institute's property and equipment consist of the following:

	December 31, 2016	December 31, 2015
Equipment	$ 438,613	$ 423,492
Furniture and fixtures	148,025	142,019
Leasehold improvements	2,157,569	2,153,948
Machines and video equipment	976,100	897,143
Medical equipment	4,989,359	4,301,646
	8,709,666	7,918,248
Less accumulated depreciation and amortization	(7,866,926)	(7,552,905)
	$ 842,740	$ 365,343

Note 5 - Line-of-Credit

The Institute has an unsecured line-of-credit with a bank available up to $1,500,000, which bears interest at the prime rate plus 0.50% with a floor of 3.75% (4.25% at December 31, 2016) and matures in March 2018. As of December 31, 2016 and 2015, the outstanding balance was $1,273,800 and $1,425,800, respectively.

Note 6 - Long-Term Debt

Long-term debt consists of the following as December 31, 2016:

Note payable to a finance company due April 2021 requiring monthly payments of $12,787. The note accrues interest at 4.39% and is collateralized by equipment.	$ 615,024
Less current portion	(129,016)
Long-term portion of debt	$ 486,008

Maturities of the note payable are as follows:

For the Year Ending December 31,	
2017	$ 129,016
2018	134,795
2019	140,833
2020	147,142
2021	63,238
	$ 615,024

Note 7 - Retirement Plan

The Institute has a defined contribution retirement plan (the "Plan") under IRC Section 401(k). Employees are eligible to participate in the Plan after one year of service. The Institute's contributions to the Plan are determined annually. The Institute contributed $31,552 and $36,352 to the Plan in fiscal years 2016 and 2015, respectively.

Note 8 - Temporarily Restricted Net Assets

The temporarily restricted net assets that have been restricted by the donors to be used only for specified purposes and/or are time restricted until payments on contributions receivable are received are as follows:

	December 31,	
	2016	2015
Assets available for		
Department of BioMedical Engineering	$ -	$ 240,237
Assets available in future periods		
Education	50,000	50,000
Center for Regenerative Sports Medicine	292,883	-
Center for Outcomes-Based Orthopaedic Research	49,402	72,664
Department of BioMedical Engineering	77,176	76,301
Time restricted only	8,185,427	9,058,057
Total contributions receivable	8,654,888	9,257,022
	$ 8,654,888	$ 9,497,259

Note 9 - Related Party Transactions

During 2016 and 2015, the Institute received approximately $1,596,000 and $688,000, respectively, in contributions from related parties, including various Board members, employees, and medical staff at The Steadman Clinic (the "Clinic"). There are two physicians of the Clinic who are Board members of the Institute.

The Institute entered into a contribution agreement as well as a lease commitment with an organization whose board chairman, CEO, and President of their Foundation are Board members of the Institute. Under the contribution agreement, the Institute recorded a contribution receivable in the amount of $10,000,000 during 2015, to be paid over 10 years. In addition, the Institute received contributions from this organization during the years ended December 31, 2016 and 2015 of approximately $4,300,000 and $355,000, respectively.

Note 9 - Related Party Transactions (continued)

In addition, the Institute received $723,000 from the Clinic during both 2016 and 2015, as a corporate sponsor and for the use of certain equipment. The balance due from the Clinic totaled $69,224 and $50,434 as of December 31, 2016 and 2015, respectively.

See Note 11 for additional related party transactions.

Note 10 - Income Taxes

Income tax expense has been computed at the statutory rates applicable during the period. The components of taxes on income are approximately as follows:

	For the Years Ended December 31, 2016	For the Years Ended December 31, 2015
Current		
Federal	$ 13,408	$ 5,224
State	3,575	1,691
	16,983	6,915
Deferred		
Federal	11,187	34,930
State	2,276	(701)
	13,463	34,229
	$ 30,446	$ 41,144

The Institute's deferred tax assets are a result of the difference in the tax and book basis of depreciable assets and net operating losses.

Note 11 - Commitments

Operating Leases

The Institute leases facilities under a non-cancelable operating lease with a related party, which calls for both base rent payments and operating expenses. The original term of the lease expired in February 2016 and the Institute has since operated under a month-to-month lease with the related party until the new lease takes effect in 2017. The new lease will expire in 2026. The Institute also leases other facilities and equipment under non-cancelable operating leases with non-related parties, expiring through September 2021. Rent under these leases for the years ended December 31, 2016 and 2015 was $593,002 and $456,784, respectively. Of these amounts, $252,818 and $245,940 for the years ended December 31, 2016 and 2015, respectively, were with a related party.

Note 11 - Commitments (continued)

Operating Leases (continued)

Future minimum lease payments under these leases are approximately as follows:

For the Year Ending December 31,	
2017	$ 573,000
2018	631,000
2019	631,000
2020	631,000
2021	477,000
Thereafter	1,372,000
	$ 4,315,000

Research Collaboration

In 2015, the Institute signed an agreement in which $7,500,000 was committed to a research collaboration over a period of five years to pay for laboratory space, staff support, researchers' salaries, equipment, and other related expenses incurred by the research collaboration. The remaining commitment as of December 31, 2016 was approximately $3,300,000.