

LUPUS RESEARCH ALLIANCE, INC. AND SUBSIDIARY

FINANCIAL STATEMENTS

DECEMBER 31, 2018 AND 2017



INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Lupus Research Alliance, Inc.

We have audited the accompanying consolidated financial statements of Lupus Research Alliance, Inc. (a nonprofit organization) and Subsidiary (the "LLC"), which comprise the consolidated statement of financial position as of December 31, 2018, and the related consolidated statements of activities, functional expenses and cash flows for the year then ended, and the related notes to the financial statements. We have also audited the accompanying financial statements of Lupus Research Alliance, Inc., which comprise the statement of financial position as of December 31, 2017, and the related statements of activities, functional expenses and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the 2018 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Lupus Research Alliance, Inc. and Subsidiary as of December 31, 2018, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America. Also, in our opinion, the 2017 financial statements present fairly, in all material respects, the financial position of Lupus Research Alliance, Inc. as of December 31, 2017, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Lotz + Carr, LLP

New York, New York
June 12, 2019

LUPUS RESEARCH ALLIANCE, INC. AND SUBSIDIARY

STATEMENTS OF FINANCIAL POSITION

DECEMBER 31, 2018 AND 2017

	<u>2018</u>	<u>2017</u>
	<u>(Consolidated)</u>	
Assets		
Cash and cash equivalents (Notes 2b and 5)	\$ 5,206,980	\$ 4,788,885
Investments (Notes 2c, 2d and 6)	53,584,534	59,650,727
Unconditional promises to give (Notes 2e and 8)	4,778,785	11,077,526
Accounts receivable	157,680	-
Prepaid expenses and other current assets	168,860	197,627
Property and equipment, at cost, net of accumulated depreciation (Notes 2f and 9)	573,771	681,864
Security deposit	609,345	609,345
	<u>609,345</u>	<u>609,345</u>
Total Assets	<u>\$ 65,079,955</u>	<u>\$77,005,974</u>
Liabilities and Net Assets		
Liabilities		
Accounts payable and other current liabilities	\$ 465,895	\$ 503,931
Research grants payable (Notes 2i and 10)	22,572,203	25,308,455
Deferred rent liability (Note 2j)	780,561	709,940
Total Liabilities	<u>23,818,659</u>	<u>26,522,326</u>
Commitments (Notes 12 and 13)		
Net Assets		
Without donor restrictions (Note 4a)	36,803,806	41,101,395
With donor restrictions (Note 4b)	4,457,490	9,382,253
Total Net Assets	<u>41,261,296</u>	<u>50,483,648</u>
Total Liabilities and Net Assets	<u>\$ 65,079,955</u>	<u>\$77,005,974</u>

See notes to financial statements.

LUPUS RESEARCH ALLIANCE, INC. AND SUBSIDIARY

STATEMENTS OF ACTIVITIES

YEARS ENDED DECEMBER 31, 2018 AND 2017

	2018			2017		
	Without Donor Restrictions	With Donor Restrictions	Total	Without Donor Restrictions	With Donor Restrictions	Total
Changes in Net Assets						
Revenue and Other Support						
Contributions (Notes 1 and 2e)	\$ 8,341,106	\$ 720,748	\$ 9,061,854	\$11,590,528	\$ 7,100,296	\$18,690,824
Special events income	5,270,865	-	5,270,865	3,881,408	-	3,881,408
Less: Expenses directly benefiting contributors	(500,138)	-	(500,138)	(490,770)	-	(490,770)
Walkathon income	1,603,816	-	1,603,816	1,651,424	-	1,651,424
Less: Expenses directly benefiting contributors	(39,862)	-	(39,862)	(39,753)	-	(39,753)
LuCIN consulting revenue (Note 2h)	1,334,475	-	1,334,475	244,406	-	244,406
Other income	-	-	-	7,557	-	7,557
Property expenses and reimbursements (Note 11)	-	-	-	(16,930)	-	(16,930)
Net investment income (loss) for operations (Note 6)	(401,511)	-	(401,511)	1,091,365	-	1,091,365
Board designated endowment spending policy withdrawals (Notes 4a and 7)	2,683,279	-	2,683,279	2,600,343	-	2,600,343
	<u>18,292,030</u>	<u>720,748</u>	<u>19,012,778</u>	<u>20,519,578</u>	<u>7,100,296</u>	<u>27,619,874</u>
Net assets released from restrictions						
Satisfaction of program restrictions	5,645,511	(5,645,511)	-	1,609,899	(1,609,899)	-
Total Revenue and Other Support	<u>23,937,541</u>	<u>(4,924,763)</u>	<u>19,012,778</u>	<u>22,129,477</u>	<u>5,490,397</u>	<u>27,619,874</u>
Expenses						
Program Services						
Research	9,608,831	-	9,608,831	10,894,950	-	10,894,950
Scientific programs	7,064,789	-	7,064,789	10,986,100	-	10,986,100
Public policy	788,377	-	788,377	776,350	-	776,350
Total Program Services	<u>17,461,997</u>	<u>-</u>	<u>17,461,997</u>	<u>22,657,400</u>	<u>-</u>	<u>22,657,400</u>
Supporting Services						
Administration	1,973,754	-	1,973,754	2,131,622	-	2,131,622
Fundraising	3,179,907	-	3,179,907	3,345,716	-	3,345,716
Total Supporting Services	<u>5,153,661</u>	<u>-</u>	<u>5,153,661</u>	<u>5,477,338</u>	<u>-</u>	<u>5,477,338</u>
Total Expenses	<u>22,615,658</u>	<u>-</u>	<u>22,615,658</u>	<u>28,134,738</u>	<u>-</u>	<u>28,134,738</u>
Increase (Decrease) in Net Assets Before Items Below	1,321,883	(4,924,763)	(3,602,880)	(6,005,261)	5,490,397	(514,864)
Non-Operating Activities						
Net investment income (loss) (Note 6)	(2,936,193)	-	(2,936,193)	8,478,913	-	8,478,913
Board designated endowment spending policy withdrawals (Notes 4a and 7)	(2,683,279)	-	(2,683,279)	(2,600,343)	-	(2,600,343)
Loss on sale of land and building held for resale (Note 11)	-	-	-	(38,977)	-	(38,977)
Increase (decrease) in net assets	(4,297,589)	(4,924,763)	(9,222,352)	(165,668)	5,490,397	5,324,729
Net assets, beginning of year	<u>41,101,395</u>	<u>9,382,253</u>	<u>50,483,648</u>	<u>41,267,063</u>	<u>3,891,856</u>	<u>45,158,919</u>
Net Assets, End of Year	<u>\$36,803,806</u>	<u>\$ 4,457,490</u>	<u>\$41,261,296</u>	<u>\$41,101,395</u>	<u>\$ 9,382,253</u>	<u>\$50,483,648</u>

See notes to financial statements.

LUPUS RESEARCH ALLIANCE, INC. AND SUBSIDIARY

STATEMENT OF FUNCTIONAL EXPENSES

YEAR ENDED DECEMBER 31, 2018 WITH COMPARATIVE TOTALS FOR 2017

	Consolidated							2017	
	2018								
	Program Services			Total	Supporting Services		Total Expenses		Total Expenses
Research	Scientific Programs	Public Policy	Administration		Fundraising	Total			
Salaries	\$ 378,189	\$ 1,045,433	\$283,168	\$ 1,706,790	\$ 808,913	\$ 1,246,172	\$2,055,085	\$ 3,761,875	\$ 3,494,979
Payroll taxes and fringe benefits	113,212	312,952	84,767	510,931	242,151	373,044	615,195	1,126,126	1,048,744
Total Personnel Expenses	491,401	1,358,385	367,935	2,217,721	1,051,064	1,619,216	2,670,280	4,888,001	4,543,723
Peer reviewed research awards	8,646,136	-	-	8,646,136	-	-	-	8,646,136	9,516,440
LuCIN Grants	-	2,520,000	-	2,520,000	-	-	-	2,520,000	8,075,114
Clinical studies	-	845,312	-	845,312	-	-	-	845,312	425,925
Professional fees and contract services	128,139	631,224	99,718	859,081	208,602	415,779	624,381	1,483,462	1,774,242
Occupancy	95,972	383,817	71,859	551,648	205,278	316,239	521,517	1,073,165	1,008,507
Printing and publications	27,743	23,492	2,459	53,694	52,387	121,704	174,091	227,785	279,701
Staff and volunteer travel	22,738	208,007	50,200	280,945	45,385	130,457	175,842	456,787	539,779
Meetings and conferences	66,768	722,874	133,755	923,397	49,730	19,316	69,046	992,443	658,440
Walkathon promotional events and location expenses	-	-	-	-	-	245,802	245,802	245,802	239,903
Postage, shipping and delivery	1,382	16,016	1,991	19,389	15,738	48,327	64,065	83,454	108,406
Management information systems	63,211	124,354	28,942	216,507	113,080	82,678	195,758	412,265	283,913
Supplies	871	32,252	951	34,074	32,760	9,461	42,221	76,295	52,336
Data processing and accounting services	25,183	-	407	25,590	87,024	46,234	133,258	158,848	154,806
Branding and design	8,750	55,701	1,841	66,292	34,701	20,777	55,478	121,770	152,307
Telephone	4,438	56,210	3,545	64,193	9,224	15,513	24,737	88,930	49,890
Insurance	4,565	26,763	3,418	34,746	9,765	15,043	24,808	59,554	62,202
Licenses	1,342	3,709	1,005	6,056	2,869	4,421	7,290	13,346	22,527
Equipment lease	3,600	9,952	2,696	16,248	7,702	11,863	19,565	35,813	26,998
Professional development	-	-	1,000	1,000	6,597	2,020	8,617	9,617	6,219
Dues and subscriptions and other expenses	25	925	4,250	5,200	6,413	467	6,880	12,080	10,741
Total expenses before depreciation	9,592,264	7,018,993	775,972	17,387,229	1,938,319	3,125,317	5,063,636	22,450,865	27,992,119
Depreciation	16,567	45,796	12,405	74,768	35,435	54,590	90,025	164,793	142,619
Total Expenses, 2018	<u>\$ 9,608,831</u>	<u>\$ 7,064,789</u>	<u>\$788,377</u>	<u>\$17,461,997</u>	<u>\$ 1,973,754</u>	<u>\$ 3,179,907</u>	<u>\$5,153,661</u>	<u>\$22,615,658</u>	
Total Expenses, 2017	<u>\$10,894,950</u>	<u>\$10,986,100</u>	<u>\$776,350</u>	<u>\$22,657,400</u>	<u>\$ 2,131,622</u>	<u>\$ 3,345,716</u>	<u>\$5,477,338</u>		<u>\$28,134,738</u>

See notes to financial statements.

LUPUS RESEARCH ALLIANCE, INC. AND SUBSIDIARY

STATEMENT OF FUNCTIONAL EXPENSES

YEAR ENDED DECEMBER 31, 2017

	Program Services			Supporting Services			Total Expenses	
	Research	Scientific Programs	Public Policy	Total	Administration	Fundraising		Total
Salaries	\$ 353,455	\$ 644,588	\$285,085	\$ 1,283,128	\$ 871,459	\$ 1,340,392	\$2,211,851	\$ 3,494,979
Payroll taxes and fringe benefits	106,062	193,423	85,546	385,031	261,499	402,214	663,713	1,048,744
Total Personnel Expenses	459,517	838,011	370,631	1,668,159	1,132,958	1,742,606	2,875,564	4,543,723
Peer reviewed research awards	9,516,440	-	-	9,516,440	-	-	-	9,516,440
LuCIN Grants	-	8,075,114	-	8,075,114	-	-	-	8,075,114
Clinical studies	425,925	-	-	425,925	-	-	-	425,925
Professional fees and contract services	159,094	916,525	127,138	1,202,757	214,237	357,248	571,485	1,774,242
Occupancy	99,555	205,663	80,297	385,515	245,455	377,537	622,992	1,008,507
Printing and publications	27,678	30,512	6,608	64,798	82,496	132,407	214,903	279,701
Staff and volunteer travel	25,090	220,766	103,397	349,253	29,892	160,634	190,526	539,779
Meetings and conferences	42,269	516,268	28,728	587,265	54,368	16,807	71,175	658,440
Walkathon promotional events and location expenses	-	-	-	-	-	239,903	239,903	239,903
Postage, shipping and delivery	1,480	20,993	2,242	24,715	18,531	65,160	83,691	108,406
Management information systems	84,808	37,515	27,942	150,265	80,588	53,060	133,648	283,913
Supplies	525	6,207	432	7,164	29,968	15,204	45,172	52,336
Data processing and accounting services	21,552	-	98	21,650	98,274	34,882	133,156	154,806
Branding and design	1,263	42,245	2,500	46,008	68,392	37,907	106,299	152,307
Telephone	6,207	9,551	4,074	19,832	11,322	18,736	30,058	49,890
Insurance	4,116	29,007	3,320	36,443	10,149	15,610	25,759	62,202
Licenses	2,278	4,155	1,838	8,271	5,616	8,640	14,256	22,527
Equipment lease	2,730	4,979	2,202	9,911	6,733	10,354	17,087	26,998
Professional development	-	120	1,020	1,140	3,051	2,028	5,079	6,219
Dues and subscriptions and other expenses	-	2,165	2,250	4,415	4,030	2,296	6,326	10,741
Total expenses before depreciation	10,880,527	10,959,796	764,717	22,605,040	2,096,060	3,291,019	5,387,079	27,992,119
Depreciation	14,423	26,304	11,633	52,360	35,562	54,697	90,259	142,619
Total Expenses	<u>\$10,894,950</u>	<u>\$10,986,100</u>	<u>\$776,350</u>	<u>\$22,657,400</u>	<u>\$ 2,131,622</u>	<u>\$ 3,345,716</u>	<u>\$5,477,338</u>	<u>\$28,134,738</u>

See notes to financial statements.

LUPUS RESEARCH ALLIANCE, INC. AND SUBSIDIARY

STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2018 AND 2017

	<u>2018</u> <u>(Consolidated)</u>	<u>2017</u>
Cash Flows From Operating Activities		
Increase (decrease) in net assets	\$ (9,222,352)	\$5,324,729
Adjustments to reconcile change in net assets to net cash used by operating activities:		
Depreciation	164,793	142,619
Realized gain on sale of investments	(960,183)	(496,860)
Unrealized (gain) loss on investments	5,510,895	(7,894,056)
Loss on sale from land and building held for resale	-	38,977
(Increase) decrease in:		
Unconditional promises to give	6,298,741	(3,296,581)
Accounts receivable	(157,680)	-
Prepaid expenses and other current assets	28,767	(14,145)
Security deposit	-	94,708
Increase (decrease) in:		
Accounts payable and other current liabilities	(38,036)	18,646
Research grants payable	(2,736,252)	3,703,986
Deferred rent	70,621	347,433
Security deposit payable	-	(28,355)
Net Cash Used By Operating Activities	<u>(1,040,686)</u>	<u>(2,058,899)</u>
Cash Flows From Investing Activities		
Acquisition of property and equipment	(56,700)	(153,554)
Purchase of investments	(9,813,629)	(8,194,307)
Proceeds from sale of investments	11,329,110	9,231,350
Proceeds from land and building held for resale	-	1,758,509
Net Cash Provided By Investing Activities	<u>1,458,781</u>	<u>2,641,998</u>
Net increase in cash and cash equivalents	418,095	583,099
Cash and cash equivalents, beginning of year	<u>4,788,885</u>	<u>4,205,786</u>
Cash and Cash Equivalents, End of Year	<u>\$ 5,206,980</u>	<u>\$4,788,885</u>

See notes to financial statements.

LUPUS RESEARCH ALLIANCE, INC. AND SUBSIDIARY**NOTES TO FINANCIAL STATEMENTS****DECEMBER 31, 2018 AND 2017****Note 1 - Organization**

Lupus Research Alliance, Inc. (the "Alliance") is a national voluntary 501(c)(3) health organization based in New York City. The Alliance is a Delaware nonprofit corporation. The mission of the Alliance is to find better treatments and ultimately prevent and cure systemic lupus erythematosus (SLE or lupus), a debilitating autoimmune disease, by supporting medical research. Lupus is a chronic autoimmune disease that causes inflammation and tissue damage to any organ system in the body. The health effects of lupus include heart attacks, strokes, seizures, organ failure, and possible death. More information can be found at lupusresearch.org. Since its founding, the Alliance has committed approximately \$193 million to fund lupus research projects. All supporting services are funded by contributions from the Board of Directors. One hundred percent (100%) of all other donations to the Alliance are available to support lupus research programs.

On January 5, 2018, Lupus Therapeutics, LLC (the "LLC"), a single member limited liability company, was formed with the Alliance as its sole member. The LLC was formed to conduct clinical trial studies.

During the years ended December 31, 2018 and 2017, the Alliance received approximately 18% of its contributions from one trust and approximately 55% of its contributions from one foundation and one trust, respectively.

Note 2 - Summary of Significant Accounting Policies**a - Principles of Consolidation**

The consolidated financial statements include the accounts of the Alliance and its subsidiary, LLC. All significant intercompany transactions and accounts have been eliminated in consolidation.

b - Cash and Cash Equivalents

For purposes of the statement of cash flows, the Alliance considers all short-term investments to be cash equivalents, except for those short-term investments managed by the Alliance's investment managers as part of their long-term investment strategies.

At December 31, 2018 and 2017, included in cash and cash equivalents is approximately \$1,121,000 and \$1,058,000, respectively, being held in interest-bearing accounts.

LUPUS RESEARCH ALLIANCE, INC. AND SUBSIDIARY**NOTES TO FINANCIAL STATEMENTS****DECEMBER 31, 2018 AND 2017****Note 2 - Summary of Significant Accounting Policies (continued)****c - Investments**

The Alliance reflects investments at fair value in the statement of financial position. Investment income including unrealized gains and losses on investments are reflected in the statement of activities as increases and decreases in net assets without donor restrictions unless their use is restricted by explicit donor stipulations or by law.

Alternative investments, which do not have readily determinable fair values, are reported based upon the underlying net asset value per share or its equivalent as a practical expedient. Net asset value per share is estimated at fair value by the fund manager or general partner in a manner consistent with accounting principles generally accepted in the United States for investment companies. The Alliance reviews and evaluates the values provided by the fund managers and general partners and agrees with the valuation methods and assumptions used in determining the net asset values of these investments. These estimated fair values may differ significantly from the values that would have been used had a ready market for these investments existed.

d - Fair Value Measurements

Fair value is an estimate of the exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants (i.e., the exit price at the measurement date). Fair value measurements are not adjusted for transaction costs. Fair value hierarchy prioritizes inputs to valuation techniques used to measure fair value into three levels.

Unadjusted quoted prices in active markets for identical assets and liabilities are referred to as Level 1 inputs. Inputs other than quoted market prices that are observable, either directly or indirectly and reasonably available are referred to as Level 2 inputs. Observable inputs reflect the assumptions market participants would use in pricing the asset or liability and are developed based on market data obtained from sources independent of the Alliance. Unobservable inputs reflect the assumptions that the Alliance develops based on available information about what market participants would use in valuing the asset or liability and are referred to as Level 3 inputs.

An asset or liability's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Availability of observable inputs can vary and is affected by a variety of factors.

LUPUS RESEARCH ALLIANCE, INC. AND SUBSIDIARY**NOTES TO FINANCIAL STATEMENTS****DECEMBER 31, 2018 AND 2017****Note 2 - Summary of Significant Accounting Policies (continued)****e - Unconditional Promises to Give and Contributions**

Contributions are recognized when the donor makes a promise to give to the Alliance, that is, in substance, unconditional. Contributions that are restricted by the donor are reported as increases in net assets without donor restrictions if the restrictions expire in the fiscal year in which the contributions are recognized. All other donor-restricted contributions are reported as increases in net assets with donor restrictions depending on the nature of the restrictions. When a restriction expires, net assets with donor restrictions are reclassified to net assets without donor restrictions. The Alliance uses the allowance method to determine uncollectible promises to give. Such allowance, when necessary, is based on prior years' experience and management's analysis of specific promises made.

f - Property and Equipment

Property, equipment, and leasehold improvements are recorded at cost. Depreciation is provided on a straight-line basis over the estimated useful lives of the related assets.

g - Financial Statement Presentation

The financial statements of the have been prepared in accordance with U.S. generally accepting accounting principles, which require the Alliance to report information regarding its financial position and activities according to the following net asset classifications:

Net Assets Without Donor Restrictions

Net assets that are not subject to donor-imposed restrictions and may be expended for any purpose in performing the primary objectives of the Alliance. These net assets may be used at the discretion of the Alliance's management and the Board of Directors.

Net Assets With Donor Restrictions

Net assets subject to stipulations imposed by donors and grantors. Some donor restrictions are temporary in nature; those restrictions will be met by actions of the Alliance or the passage of time. Other donor restrictions are perpetual in nature, whereby the donor has stipulated the funds be maintained in perpetuity.

h - Revenue Recognition

Revenue from consulting is recognized when the services take place.

LUPUS RESEARCH ALLIANCE, INC. AND SUBSIDIARY**NOTES TO FINANCIAL STATEMENTS****DECEMBER 31, 2018 AND 2017****Note 2 - Summary of Significant Accounting Policies (continued)****i - Grants Awarded**

Unconditional grants awarded are recognized as expenses at fair value in the period the award is made.

j - Deferred Rent Liability

The Alliance records rent expense associated with its office leases on a straight-line basis over the life of the leases (Note 12a). The difference between the straight-line amount and the amount actually paid during the year is recorded as a liability and an expense in the accompanying financial statements.

k - Functional Allocation of Expenses

The cost of providing the various programs and supporting services has been summarized on a functional basis in the statement of activities. The Alliance's primary programming areas are categorized as Research, Scientific Programs and Public Policy. Accordingly, certain costs have been allocated among the programs and the supporting services benefited. Expenses are allocated directly to programs, where applicable, on a reasonable and consistent basis. A substantial portion of the Alliance's expenses are directly related to program activities. Certain other expenses are attributable to more than one program or supporting function and require allocation. The expenses that are allocated include salaries, payroll taxes and benefits, which are allocated on the basis of estimates of employee time and effort, while occupancy, telephone, insurance, licenses, equipment lease, and depreciation are allocated on overall salary percentages.

l - Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

m - Tax Status

Lupus Research Alliance, Inc. is a not-for-profit corporation that is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code and has been designated as an organization which is not a private foundation.

n - Subsequent Events

The Alliance has evaluated subsequent events through June 12, 2019, the date that the financial statements are considered available to be issued.

LUPUS RESEARCH ALLIANCE, INC. AND SUBSIDIARY**NOTES TO FINANCIAL STATEMENTS****DECEMBER 31, 2018 AND 2017****Note 2 - Summary of Significant Accounting Policies (continued)****o - Recent Accounting Pronouncements**

The Alliance adopted Accounting Standards Update (ASU) No. 2016-14, *Not-for-Profit Entities (Topic 958), Presentation of Financial Statements of Not-for-Profit Entities*. The ASU amends the current reporting model for nonprofit organizations and enhances their required disclosures. The major changes include: (a) requiring the presentation of only two classes of net assets now entitled “net assets without donor restrictions” and “net assets with donor restrictions”; (b) requiring the disclosure of quantitative and qualitative information regarding liquidity and availability of resources; (c) requiring that all nonprofits present an analysis of expenses by function and nature and disclose the methods used to allocate costs; and (d) modifying other financial statement reporting requirements and disclosures intended to increase the usefulness of nonprofit financial statements. As permitted under the ASU in the year of adoption, the Alliance opted to not disclose liquidity and availability information for 2017.

In February 2016, the FASB issued ASU 2016-02, “*Leases (Topic 842)*”. The core principles of ASU 2016-02 change the way organizations will account for their leases by recognizing lease assets and related liabilities on the statement of financial position for all leases with terms longer than 12 months and disclosing key information about leasing arrangements. ASU 2016-02 is effective for fiscal years beginning after December 15, 2019. The Alliance is currently evaluating the impact of ASU 2016-02 on its financial statements.

Note 3 - Information Regarding Liquidity and Availability

The Alliance operates with a balanced budget for each fiscal year based on the revenue expected to be available to fund anticipated expenses. A substantial portion of annual revenue is comprised of contribution revenue raised during the current year. The Alliance considers general expenditures to consist of all expenses related to its ongoing program activities, and the expenses related to administrative and fundraising activities undertaken to support those services.

The Alliance regularly monitors liquidity to meet its operating needs and other commitments and obligations, while seeking to maximize the investment of its available funds. Management prepares regular cash flow projections to determine liquidity needs and has a policy to maintain liquid financial assets on an ongoing basis sufficient to cover ninety days of general expenditures.

LUPUS RESEARCH ALLIANCE, INC. AND SUBSIDIARY

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2018 AND 2017

Note 3 - Information Regarding Liquidity and Availability

The Alliance's financial assets as of December 31, 2018 that are available within one year to meet cash needs for general expenditures are summarized as follows:

Financial Assets at Year End:	
Cash and cash equivalents	\$ 5,206,980
Investments	53,584,534
Unconditional promises to give	4,778,785
Accounts receivable	<u>157,680</u>
Total Financial Assets	63,727,979
Less: Amounts not Available to be Used within One Year:	
Net assets with donor restrictions subject to expenditure for specific purposes or passage of time	(4,457,490)
Plus: Net assets with donor restrictions expected to be met within one year	3,330,859
Net assets restricted by Board and subject to spending policy and appropriation	(46,122,925)
Plus: Amount appropriated in the budget for use within one year	<u>2,735,923</u>
Financial Assets Available to Meet General Expenditures within One Year	<u>\$19,214,346</u>

In addition to these financial assets available within one year, the Alliance has board designated endowment funds not appropriated for use within one year of approximately \$43,387,000, which are invested for long-term appreciation and current income. However, these funds could be made available at any time to meet cash needs for general expenditures at the discretion of the Board.

LUPUS RESEARCH ALLIANCE, INC. AND SUBSIDIARY

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2018 AND 2017

Note 4 - Net Assetsa - Net Assets Without Donor Restrictions

Net assets without donor restrictions at December 31, 2018 and 2017 consist of the following:

	<u>2018</u>	<u>2017</u>
Board designated endowment	\$46,122,925	\$51,742,397
Accumulated net spending	<u>(9,319,119)</u>	<u>(10,641,002)</u>
Total Net Assets Without Donor Restrictions	<u>\$36,803,806</u>	<u>\$41,101,395</u>

The Board of Directors established a board designated endowment for lupus research (Note 7). Investment return, net of spending policy withdrawals, are added to the board designated endowment.

The accumulated net spending represents the net spending on research and operations since inception.

b - Net Assets With Donor Restrictions

Net assets with donor restrictions at December 31, 2018 and 2017 are restricted for the following future programs and periods:

	<u>2018</u>	<u>2017</u>
Future periods	\$3,944,860	\$8,767,187
Lupus Index	225,000	-
Conferences	90,000	-
Patient advocacy fund	197,630	182,563
Clinical trials	-	378,000
Mobile application and hardware	-	40,503
Benefit event	<u>-</u>	<u>14,000</u>
Total Net Assets With Donor Restrictions	<u>\$4,457,490</u>	<u>\$9,382,253</u>

Note 5 - Concentration of Credit Risk

The Alliance maintains its cash balances in a number of financial institutions. The balances are insured by the Federal Deposit Insurance Corporation up to \$250,000 at December 31, 2018. At times throughout the year, the balances may exceed these limits.

LUPUS RESEARCH ALLIANCE, INC. AND SUBSIDIARY

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2018 AND 2017

Note 6 - Investments

Investments consist of the following at December 31, 2018 and 2017.

	2018		2017	
	Cost	Fair Value	Cost	Fair Value
Common Stock:				
Domestic	\$19,755,472	\$32,211,309	\$17,745,980	\$33,251,479
Foreign	2,378,514	2,360,236	2,821,109	3,505,700
Mutual Funds:				
Domestic equities	2,241,439	2,390,744	4,390,035	5,091,593
Foreign equities	2,119,154	2,168,933	3,125,917	3,978,550
Domestic fixed income	3,658,321	3,630,677	1,663,000	1,667,567
Foreign fixed income	910,000	835,317	910,000	948,248
Real assets	2,738,368	2,531,867	3,209,625	3,169,721
Fixed Income:				
Corporate bonds	2,601,586	2,473,409	2,475,430	2,431,977
Government obligations	1,943,545	1,879,089	1,886,764	1,830,668
Mortgage backed securities	248,008	240,203	280,681	276,112
Cash and short-term investments	1,347,785	1,347,785	1,988,949	1,988,949
Alternative Investments:				
Long/short - absolute return	550,000	609,350	550,000	636,705
Capital appreciation	<u>800,000</u>	<u>905,615</u>	<u>800,000</u>	<u>873,458</u>
	<u>\$41,292,192</u>	<u>\$53,584,534</u>	<u>\$41,847,490</u>	<u>\$59,650,727</u>

At December 31, 2018 and 2017, approximately 43% and 42%, respectively, of total investments was invested in one Fortune 500 company.

LUPUS RESEARCH ALLIANCE, INC. AND SUBSIDIARY

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2018 AND 2017

Note 6 - Investments (continued)

The following summarizes the fair value of the investments that are measured on a recurring basis at December 31, 2018 and 2017.

	2018		2017	
	Total	Level 1	Total	Level 1
Common stock:				
Domestic	\$32,211,309	\$32,211,309	\$33,251,479	\$33,251,479
Foreign	2,360,236	2,360,236	3,505,700	3,505,700
Mutual Funds:				
Domestic equities	2,390,744	2,390,744	5,091,593	5,091,593
Foreign equities	2,168,933	2,168,933	3,978,550	3,978,550
Domestic fixed income	3,630,677	3,630,677	1,667,567	1,667,567
Foreign fixed income	835,317	835,317	948,248	948,248
Real assets	2,531,867	2,531,867	3,169,721	3,169,721
Fixed income:				
Corporate bonds	2,473,409	2,473,409	2,431,977	2,431,977
Government obligations	1,879,089	1,879,089	1,830,668	1,830,668
Mortgage backed securities	240,203	240,203	276,112	276,112
Cash and short-term investments	<u>1,347,785</u>	<u>1,347,785</u>	<u>1,988,949</u>	<u>1,988,949</u>
Total Assets in Fair Value Hierarchy	52,069,569	<u>\$52,069,569</u>	58,140,564	<u>\$58,140,564</u>
Investments measured at net asset value	<u>1,514,965</u>		<u>1,510,163</u>	
	<u>\$53,584,534</u>		<u>\$59,650,727</u>	

Net investment income for the years ended December 31, 2018 and 2017 is summarized as follows:

	2018		
	Without Donor Restrictions		
	Operating	Board Designated Endowment	Total
Interest and dividends	\$ 197,625	\$ 1,138,678	\$ 1,336,303
Realized gain on sale of investments	114,939	845,244	960,183
Unrealized loss on investments	<u>(698,504)</u>	<u>(4,812,391)</u>	<u>(5,510,895)</u>
	<u>(385,940)</u>	<u>(2,828,469)</u>	<u>(3,214,409)</u>
Less: Investment fees	<u>(15,571)</u>	<u>(107,724)</u>	<u>(123,295)</u>
Net Investment Loss	<u>\$(401,511)</u>	<u>\$(2,936,193)</u>	<u>\$(3,337,704)</u>

LUPUS RESEARCH ALLIANCE, INC. AND SUBSIDIARY

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2018 AND 2017

Note 6 - Investments (continued)

	<u>2017</u>		
	<u>Without Donor Restrictions</u>		
	<u>Operating</u>	<u>Board Designated Endowment</u>	<u>Total</u>
Interest and dividends	\$ 148,322	\$1,150,753	\$1,299,075
Realized gain on sale of investments	65,841	431,019	496,860
Unrealized gain on investments	<u>890,497</u>	<u>7,003,559</u>	<u>7,894,056</u>
	1,104,660	8,585,331	9,689,991
Less: Investment fees	<u>(13,295)</u>	<u>(106,418)</u>	<u>(119,713)</u>
Net Investment Income	<u>\$1,091,365</u>	<u>\$8,478,913</u>	<u>\$9,570,278</u>

The alternative investments included in the Alliance's investment portfolio at December 31, 2018 and 2017 are redeemable based on the following terms and conditions:

	<u>2018</u>	<u>2017</u>
Monthly with 45 days' notice	\$ 609,350	\$ 636,705
Quarterly with 100 days' notice	<u>905,615</u>	<u>873,458</u>
	<u>\$1,514,965</u>	<u>\$1,510,163</u>

The following are descriptions of the investment strategies of the alternative investments:

Long/Short - Absolute Return

Invests in long/short equity, fixed income and currencies focused on various global regions and sectors including emerging markets.

Capital Appreciation

Invests in long/short equity, event driven/distressed credit, asset-backed securities, global macro and relative value.

LUPUS RESEARCH ALLIANCE, INC. AND SUBSIDIARY

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2018 AND 2017

Note 7 - Endowment Funds

The Alliance's endowment consists of a board designated endowment which was established to fund research projects and consists solely of funds designated by the Board of Directors to function as an endowment. As required by generally accepted accounting principles, net assets associated with endowment funds, including funds designated by the Board of Directors to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

Changes in the Alliance's board designated endowment funds for the years ended December 31, 2018 and 2017 are summarized as follows:

	<u>2018</u>	<u>2017</u>
Endowment funds, beginning of year	\$51,742,397	\$45,863,827
Investment Return:		
Interest and dividends	1,138,678	1,150,753
Net realized and unrealized gains (losses)	(3,967,147)	7,434,578
Investment fees	<u>(107,724)</u>	<u>(106,418)</u>
Total Investment Return (Loss)	<u>(2,936,193)</u>	<u>8,478,913</u>
Spending policy withdrawals	<u>(2,683,279)</u>	<u>(2,600,343)</u>
Endowment Funds, End of Year	<u>\$46,122,925</u>	<u>\$51,742,397</u>

The Board of Directors has established a spending policy of up to 5% per year of the three-year moving average of the market value of the portfolio to support research projects. Additional funds may be used for special research projects at the Board's discretion.

The Alliance has adopted an investment policy. To satisfy long-term rate-of-return objectives, the investment policy relies on a total return strategy in which investment returns are achieved through asset appreciation (realized and unrealized) and current yield (interest and dividends). The policy targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives. The asset allocation includes equities, mutual funds, cash, real estate investment trusts, short-term investments and alternative investments.

LUPUS RESEARCH ALLIANCE, INC. AND SUBSIDIARY

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2018 AND 2017

Note 8 - Unconditional Promises to Give

Unconditional promises to give at December 31, 2018 and 2017 are due as follows:

	2018		
	Without Donor Restrictions	With Donor Restrictions	Total
Due in less than one year	\$896,425	\$3,070,000	\$3,966,425
Due in one to five years	-	855,000	855,000
	<u>896,425</u>	<u>3,925,000</u>	<u>4,821,425</u>
Less: Discount to present value	<u>-</u>	<u>(42,640)</u>	<u>(42,640)</u>
	<u><u>\$896,425</u></u>	<u><u>\$3,882,360</u></u>	<u><u>\$4,778,785</u></u>
	2017		
	Without Donor Restrictions	With Donor Restrictions	Total
Due in less than one year	\$2,148,076	\$5,303,000	\$ 7,451,076
Due in one to five years	171,426	3,651,000	3,822,426
	<u>2,319,502</u>	<u>8,954,000</u>	<u>11,273,502</u>
Less: Discount to present value	<u>(12,163)</u>	<u>(183,813)</u>	<u>(195,976)</u>
	<u><u>\$2,307,339</u></u>	<u><u>\$8,770,187</u></u>	<u><u>\$11,077,526</u></u>

Uncollectible promises are expected to be insignificant. Unconditional promises to give due after one year are discounted to net present value using the discount rate of 3%.

At December 31, 2018 and 2017, approximately 53% and 70%, respectively, of unconditional promises to give were from two donors.

LUPUS RESEARCH ALLIANCE, INC. AND SUBSIDIARY

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2018 AND 2017

Note 9 - Property and Equipment

Property and equipment at December 31, 2018 and 2017 consist of the following:

	<u>Life</u>	<u>2018</u>	<u>2017</u>
Furniture, fixtures and equipment	3-5 years	\$ 336,526	\$332,198
Computer equipment	3-5 years	245,527	220,125
Leasehold improvements	Life of lease	<u>422,712</u>	<u>395,742</u>
		1,004,765	948,065
Less: Accumulated depreciation		<u>(430,994)</u>	<u>(266,201)</u>
		<u>\$ 573,771</u>	<u>\$681,864</u>

Note 10 - Grants Payable

Grants payable at December 31, 2018 and 2017 are due as follows:

	<u>2018</u>	<u>2017</u>
Due within one year	\$16,127,533	\$17,194,540
Due within one to three years	<u>6,781,751</u>	<u>8,576,082</u>
	22,909,284	25,770,622
Less: Discount to present value	<u>(337,081)</u>	<u>(462,167)</u>
	<u>\$22,572,203</u>	<u>\$25,308,455</u>

Research grants payable for periods due after one year are discounted to net present value using a discount rate of 3%.

LUPUS RESEARCH ALLIANCE, INC. AND SUBSIDIARY

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2018 AND 2017

Note 11 - Land and Building Held for Resale

In December 2006, the Alliance received a donation of land and building (the "Property"). In February 2017, the Alliance sold the property and recognized a loss on the sale determined as follows:

Sales price	\$1,900,000
Less: Closing costs	<u>(141,491)</u>
Net proceeds	<u>1,758,509</u>
Less:	
Book value of property sold	1,725,928
Unamortized leasing costs	<u>71,558</u>
	<u>1,797,486</u>
Net Loss on Sale	<u>\$ (38,977)</u>

Note 12 - Commitments

a - The Alliance leases office space in New York, NY for its main office and in Arlington, VA and Chicago, IL for its branch offices. The leases provide for minimum annual payments as follows:

<u>Year Ending December 31,</u>	
2019	\$ 964,787
2020	986,799
2021	1,009,313
2022	1,055,204
2023	824,647
Thereafter, through April 30, 2027	3,628,249

Rent expense for the years ended December 31, 2018 and 2017 was \$1,064,266 and \$1,001,401, respectively.

b - The Alliance has commitments of approximately \$1,037,300 for consulting services through December 31, 2021.

LUPUS RESEARCH ALLIANCE, INC. AND SUBSIDIARY

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2018 AND 2017

Note 13 - Employee Benefit Plan - Defined Contribution Plan

The Alliance maintains a defined contribution retirement plan (the "Plan"). The Alliance contributes up to 4% of each employee's eligible compensation and at the Alliance's discretion, makes an additional contribution between 4% and 7% the employee's eligible compensation depending on years of service. The contributions are subject to limitations as stated in relevant provisions of the Internal Revenue Code. Total contributions to the plan for the years ended December 31, 2018 and 2017 was \$284,103 and \$259,533, respectively.

Note 14 - Joint Costs

The Alliance achieves certain educational goals for its science program during its walkathon promotional events by providing informational discussions and materials regarding lupus research. The cost of conducting those joint activities included joint costs that are not directly attributable to either the program component or the fundraising component of the activities. Those joint costs were allocated as follows:

	<u>2018</u>	<u>2017</u>
Fundraising	\$245,802	\$239,903
Scientific programs	<u>61,450</u>	<u>59,976</u>
Total	<u>\$307,252</u>	<u>\$299,879</u>