



**AMERICAN DIABETES ASSOCIATION
RESEARCH FOUNDATION, INC.**

Financial Statements

December 31, 2018

(With Independent Auditors' Report Thereon)



KPMG LLP
1676 International Drive
McLean, VA 22102

Independent Auditors' Report

The Board of Directors
American Diabetes Association
Research Foundation, Inc.:

Report on the Financial Statements

We have audited the accompanying financial statements of American Diabetes Association Research Foundation, Inc., which comprise the balance sheet as of December 31, 2018, 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 U.S. generally accepted accounting principles; 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 audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 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 financial statements referred to above present fairly, in all material respects, the financial position of the American Diabetes Association Research Foundation, Inc. as of December 31, 2018 and the results of their operations and their cash flows for the year then ended in accordance with U.S. generally accepted accounting principles.



Emphasis of Matter

As discussed in Note 2(h) to the financial statements, in 2018 American Diabetes Association Research Foundation, Inc. adopted new accounting guidance, Accounting Standards Update (ASU) 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*. Our opinion is not modified with respect to this matter.

Report on Summarized Comparative Information

We have previously audited the American Diabetes Association Research Foundation, Inc. 2017 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated May 29, 2018. In our opinion, the summarized comparative information presented herein as of and for the year ended December 31, 2017 is consistent, in all material respects, with the audited financial statements from which it has been derived before the adjustments to adopt ASU 2016-14. As part of our audit of the 2018 financial statements, we also audited the adjustments described in Note 2(h) that were applied to adopt ASU 2016-14 retrospectively in the 2017 financial statements. In our opinion, such adjustments are appropriate and have been properly applied.

KPMG LLP

McLean, Virginia
May 28, 2019

**AMERICAN DIABETES ASSOCIATION
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Balance Sheet

December 31, 2018

(with comparative information as of December 31, 2017)

| Assets | 2018 | 2017 |
|--|---------------|-------------|
| Cash and cash equivalents | \$ 119,717 | 858,474 |
| Receivable from the American Diabetes Association (note 3) | 50,215,101 | 63,289,465 |
| Contributions receivable, net (note 6) | 358,458 | 417,163 |
| Interest in perpetual trust (note 5) | 79,445 | 85,626 |
| Total assets | \$ 50,772,721 | 64,650,728 |
| Liabilities and Net Assets | | |
| Research grants payable | \$ 23,510,548 | 26,897,799 |
| Net assets: | | |
| Without donor restrictions | — | 5,732,502 |
| With donor restrictions | 27,262,173 | 32,020,427 |
| Total net assets | 27,262,173 | 37,752,929 |
| Total liabilities and net assets | \$ 50,772,721 | 64,650,728 |

See accompanying notes to financial statements.

**AMERICAN DIABETES ASSOCIATION
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Statement of Activities

Year ended December 31, 2018
(with summarized information for the year ended December 31, 2017)

| | Without donor restrictions | With donor restrictions | 2018 Total | 2017 Total |
|--|---------------------------------------|------------------------------------|-----------------------|-----------------------|
| Revenue: | | | | |
| Donations, bequests, and change in value of perpetual trusts | \$ 3,326,177 | 200,343 | 3,526,520 | 3,189,834 |
| Contributed professional services | 874,032 | — | 874,032 | 817,451 |
| Grant from the American Diabetes Association (note 4) | 9,240,493 | 3,669,771 | 12,910,264 | 31,937,518 |
| Total contributions and grants | 13,440,702 | 3,870,114 | 17,310,816 | 35,944,803 |
| Net assets released from restrictions | 8,628,368 | (8,628,368) | — | — |
| Total revenue | 22,069,070 | (4,758,254) | 17,310,816 | 35,944,803 |
| Expenses: | | | | |
| Program activities – research: | | | | |
| Research grants | 26,235,671 | — | 26,235,671 | 36,557,070 |
| Contributed professional services | 874,032 | — | 874,032 | 817,451 |
| Total program activities | 27,109,703 | — | 27,109,703 | 37,374,521 |
| Supporting services: | | | | |
| Management and general | 259,451 | — | 259,451 | 248,980 |
| Fundraising | 432,418 | — | 432,418 | 414,966 |
| Total supporting services | 691,869 | — | 691,869 | 663,946 |
| Total expenses | 27,801,572 | — | 27,801,572 | 38,038,467 |
| Change in net assets | (5,732,502) | (4,758,254) | (10,490,756) | (2,093,664) |
| Net assets, beginning of year | 5,732,502 | 32,020,427 | 37,752,929 | 39,846,593 |
| Net assets, end of year | \$ — | 27,262,173 | 27,262,173 | 37,752,929 |

See accompanying notes to financial statements.

**AMERICAN DIABETES ASSOCIATION
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Statement of Functional Expenses

Year ended December 31, 2018

(with summarized information for the year ended December 31, 2017)

| | Program activities research | Supporting services | | 2018 Total | 2017 Total |
|---|--|-----------------------------------|--------------------|-----------------------|-----------------------|
| | | Management and general | Fundraising | | |
| Research grants | \$ 26,235,671 | — | — | 26,235,671 | 36,557,070 |
| American Diabetes Association management fee | — | 259,451 | 432,418 | 691,869 | 663,946 |
| Contributed professional services | 874,032 | — | — | 874,032 | 817,451 |
| Total expenses | <u>\$ 27,109,703</u> | <u>259,451</u> | <u>432,418</u> | <u>27,801,572</u> | <u>38,038,467</u> |

See accompanying notes to financial statements.

**AMERICAN DIABETES ASSOCIATION
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Statement of Cash Flows

Year ended December 31, 2018

(with comparative information for the year ended December 31, 2017)

| | 2018 | 2017 |
|--|-----------------|-------------|
| Cash flows from operating activities: | | |
| Change in net assets | \$ (10,490,756) | (2,093,664) |
| Adjustments to reconcile change in net assets to net cash (used in) provided by operating activities: | | |
| Decrease (increase) in interest in perpetual trust | 6,181 | (3,875) |
| Adjustments for changes in operating assets and liabilities: | | |
| Decrease (increase) in receivable from the American Diabetes Association | 13,074,364 | (8,297,907) |
| Decrease in contributions receivable | 58,705 | 3,343,686 |
| (Decrease) increase in research grants payable | (3,387,251) | 7,910,234 |
| Net cash (used in) provided by operating activities | (738,757) | 858,474 |
| Cash and cash equivalents, beginning of year | 858,474 | — |
| Cash and cash equivalents, end of year | \$ 119,717 | 858,474 |

See accompanying notes to financial statements.

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Notes to Financial Statements

December 31, 2018

(1) Organization

The American Diabetes Association (the Association) is a not-for-profit voluntary health agency that works to prevent and cure diabetes and to improve the lives of all people affected by diabetes. In October 1994, the Association's board of directors established the American Diabetes Association Research Foundation, Inc. (the Foundation), as a subsidiary of the Association. The objective of the Foundation is to fund diabetes-related research leading to:

- The prevention and cure of diabetes
- The prevention and cure of the complications of diabetes
- New and improved therapies for individuals affected by diabetes

The Foundation is generally exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code (the Code) and charitable contributions to the Foundation qualify for charitable tax deductions as described in the Code. The Foundation is subject to taxation on any net unrelated business income and has been classified as an organization that is not a private foundation under Section 509(a) of the Code.

The Foundation recognizes the effect of income tax positions only if those positions more likely than not would not be sustained upon examination by the Internal Revenue Service. The Foundation has analyzed the tax positions taken and has concluded that as of December 31, 2018, there are no uncertain tax positions taken or expected to be taken that would require recognition of a liability (or asset) or disclosure in the financial statements.

The Tax Cuts and Jobs Act (the Tax Act) was signed into law on December 22, 2017. The Tax Act includes several changes relevant to tax-exempt organizations, primarily related to unrelated business income, net operating losses, certain new excise taxes, and changes affecting the deductibility of certain expenses. Management has determined that the new law will not have a significant impact on the Foundation's financial statements.

The Foundation has been and continues to be dependent on the continued financial support of the Association to operate its core programs. The Association is committed to continue such support as necessary in order for the Foundation to sustain its research activities and to continue as a going concern.

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting

The Foundation prepares its financial statements on an accrual basis in accordance with U.S. generally accepted accounting principles.

The net assets and revenues, gains, and losses of the Foundation are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the Foundation are classified and reported as follows:

Without donor restrictions – Net assets that are not subject to donor-imposed stipulations.

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With donor restrictions – Net assets with donor restrictions carry specific donor-imposed stipulations that will be met either by actions of the Foundation and/or the passage of time. Other net assets with donor restrictions include net assets with stipulations that require the corpus of the gifts to be retained permanently with only the income to be used to support operations or another specified purpose.

(b) Cash and Cash Equivalents

Cash and cash equivalents are defined as currency on hand, demand deposits with banks or financial institutions, and financial instruments with original maturities of less than three months.

(c) Recognition of Revenues

Contributions, including unconditional promises to give, are recognized when received. The research program is the sole program of the Foundation. Therefore, all contributions to the general research program are reported as revenues without donor restrictions unless further restricted by the donor. Generally, there is no time restriction presumed on unconditional promises to give as it is the practice of the Foundation to spend these contributions on the research program in the same year as received. Contributions recognized in 2018 with donor restrictions are more specifically restricted than the broad research mission of the Foundation.

Unconditional promises to give are reported at their net realizable value. These unconditional promises to give are reported at fair value based on nonrecurring measurements classified as Level 3 (note 5). Unconditional promises to give that are expected to be collected in future years are recorded at the present value of the amounts expected to be collected. The present value discount is calculated using a risk-adjusted rate at the time of the contribution of 3.0%.

(d) Contributed Services

Contributed services are reported in the statement of activities at the fair value of the services received. Contributions of services are recognized if the services received create or enhance nonfinancial assets or if the services require specialized skills and would typically need to be purchased if not provided by donation. Contributed services reported by the Foundation relate to the panel review of research grant applications and are recorded as both contributed professional services revenue and expense on the statement of activities.

(e) Research Grants

Research grants awarded by the Foundation generally extend over a period of one to five years, subject to renewal on an annual basis. The liability and related expense is recorded when the recipient is notified of the annual award amount, and the liability is recorded as research grants payable in the balance sheet.

(f) Management Estimates and Uncertainties

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

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(g) Comparative Financial Statements

The statements of activities and functional expenses include certain summarized comparative information for the year ended December 31, 2017. Such information does not include sufficient detail to constitute a presentation in conformity with generally accepted accounting principles. Accordingly, such information should be read in conjunction with the Foundation's financial statements for the year ended December 31, 2017, from which the summarized information was derived.

(h) Recent Accounting Pronouncements

Not-for-Profit Financial Statement Presentation

In August 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2016-14 (ASU 2016-14), *Presentation of Financial Statements of Not-for-Profit Entities*. This guidance is intended to improve the net asset classification requirements and the information presented in the financial statements and notes about a not-for-profit entity's liquidity, financial performance, and cash flows. Main provisions of this guidance include: presentation of two classes of net assets versus the previously required three; recognition of capital gifts for construction as a net asset without donor restrictions when the associated long-lived asset is placed in service; and recognition of underwater endowment funds as a reduction in net assets with donor restrictions. The guidance also requires enhanced disclosures for board designated amounts, composition of net assets without donor restrictions, liquidity, and the presentation of expenses by both their natural and functional classification.

The Foundation adopted the provisions of ASU 2016-14 in 2018 and has applied the provisions retrospectively as required by the standard. A presentation of net assets as previously reported as of December 31, 2017 follows:

| | As previously presented | Presentation under ASU 2016-14 | | |
|---|-------------------------|--------------------------------|-------------------------|-------------------|
| | | Without donor restrictions | With donor restrictions | Total |
| Net assets: | | | | |
| Unrestricted | \$ 5,732,502 | 5,732,502 | — | 5,732,502 |
| Temporarily restricted | 31,934,801 | — | 31,934,801 | 31,934,801 |
| Permanently restricted | 85,626 | — | 85,626 | 85,626 |
| Total net assets | <u>\$ 37,752,929</u> | <u>5,732,502</u> | <u>32,020,427</u> | <u>37,752,929</u> |
| Net assets as restated in accordance with ASU 2016-14 | | <u>\$ 5,732,502</u> | <u>32,020,427</u> | <u>37,752,929</u> |

(3) Financial Assets and Liquidity Reserves

The Foundation funds its operations through contributions from donors and from a grant from the Association, to the extent that private donations are not sufficient to meet its research grant commitments. Cash required to meet operating needs is invested in short term accounts.

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The following is a reconciliation of the Foundation's financial assets as of December 31, 2018 to financial assets available to fund the Foundation's general expenditures for the following fiscal year. General expenditures include all programmatic and supporting operating expenditures.

| | | |
|--|----|--------------------------|
| Cash and cash equivalents | \$ | 119,717 |
| Receivable from the American Diabetes Association | | 50,215,101 |
| Contributions receivable, net | | <u>358,458</u> |
| Total financial assets at December 31, 2018 | | 50,693,276 |
| Less financial assets unavailable for general expenditure within one year: | | |
| Contributions receivable due after one year, net | | (240,665) |
| Donor restricted net assets that are not expected to be spent within one year | | <u>(18,055,729)</u> |
| Financial assets available to meet cash needs for general expenditures within one year | \$ | <u><u>32,396,882</u></u> |

(4) Transactions with the American Diabetes Association

(a) Research Program

The Foundation facilitates the Association's research program. Accordingly, all contributions for research raised by the Association are granted to the Foundation. These research restricted contributions to the Association totaled \$4,781,101 and \$2,893,465 in 2018 and 2017, respectively. The Foundation also receives gifts for research directly from donors, which are reported as contributions in the statement of activities.

(b) Grants from the American Diabetes Association and Management Fee

The Association provides grants to the Foundation for its research purpose as determined annually based on a formal budgeting process, which is approved by the Association's board of directors. The Foundation is reliant on this grant support, as well as donor support, for its continued operations.

The Foundation pays a management fee to the Association equal to twenty percent of contributions. This fee compensates the Association for staff and other administrative services provided to the Foundation. The management fee assessed on contributions for the Pathway to Stop Diabetes research campaign is spread over five years to align with the grant award schedule.

The Association transfers assets to the Foundation based on the timing of grant payments due. As of December 31, 2018 and 2017, the Association owed the Foundation \$50,215,101 and \$63,289,465, respectively.

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(5) Fair Value Measurements

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Those fair value measurements maximize the use of observable inputs. However, in situations where there is little, if any, market activity for the asset or liability at the measurement date, the fair value reflects the Foundation's own judgments about the assumptions that market participants would use in pricing the asset or liability. Those judgments are developed by the Foundation based on the best information available in the circumstances.

A fair value hierarchy prioritizes the inputs into valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and lowest priority to unobservable inputs (Level 3 measurements). The level of the hierarchy for the Foundation is as follows:

Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the asset or liabilities. The Foundation's interest in perpetual trusts is carried at the fair value of the Foundation's share of the trust assets, which was \$79,445 and \$85,626 for 2018 and 2017, respectively. These were presented as Level 3 for both 2018 and 2017. Distributions from the trusts are recorded as investment income and the trust values are adjusted annually for changes in the fair value of the trust assets.

(6) Contributions Receivable

Contributions receivable as of December 31, 2018 and 2017, are expected to be received as follows:

| | <u>2018</u> | <u>2017</u> |
|---------------------------------|-------------------|----------------|
| Within one year | \$ 1,250,793 | 1,198,023 |
| In one to five years | <u>75,000</u> | <u>102,150</u> |
| Total contributions receivable | 1,325,793 | 1,300,173 |
| Less: | | |
| Allowance for doubtful accounts | (1,133,000) | (1,063,000) |
| Present value discount | <u>(4,276)</u> | <u>(1,570)</u> |
| Subtotal | 188,517 | 235,603 |
| Funds held in remainder trusts | <u>169,941</u> | <u>181,560</u> |
| Contributions receivable, net | <u>\$ 358,458</u> | <u>417,163</u> |

(7) Subsequent Events

For the year ended December 31, 2018, the Association has evaluated subsequent events through May 28, 2019, the date the financial statements were available to be issued, and determined that no items required disclosure.