

THE PROSPECT HILL FOUNDATION, INC.

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITOR'S REPORT
YEARS ENDED JUNE 30, 2016 AND 2015**

THE PROSPECT HILL FOUNDATION, INC.

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January __, 2017

Board of Directors
The Prospect Hill Foundation, Inc.
New York, New York

INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying financial statements of The Prospect Hill Foundation, Inc. (the "Foundation"), which comprise the statements of assets, liabilities, and net assets – modified cash basis as of June 30, 2016 and 2015, and the related statements of investment (loss) income, expenses and changes in net assets - modified cash basis, and cash flows - modified cash basis for the years 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 the modified cash basis of accounting as described in Note 2; this includes determining that the modified cash basis of accounting is an acceptable basis for the preparation of the financial statements in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our 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 from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets, liabilities, and net assets of The Prospect Hill Foundation, Inc. as of June 30, 2016 and 2015, and its investment (loss) income, expenses and changes in net assets and cash flows for the years then ended in accordance with the modified cash basis of accounting as described in Note 2.

Basis of Accounting

We draw attention to Note 2 of the financial statements, which describes the basis of accounting. The financial statements are prepared on the modified cash basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Elliot Horowitz & Company, LLP

THE PROSPECT HILL FOUNDATION, INC.

**STATEMENTS OF ASSETS, LIABILITIES AND NET ASSETS -
MODIFIED CASH BASIS
JUNE 30, 2016 AND 2015**

	<u>2016</u>	<u>2015</u>
CASH AND CASH EQUIVALENTS	\$ 448,536	\$ (25,515)
INVESTMENTS AT FAIR VALUE (cost \$53,668,757 and \$54,260,706 in 2016 and 2015, respectively)	57,072,711	62,533,975
PROPERTY AND EQUIPMENT, AT COST	<u>10,330</u>	<u>16,425</u>
TOTAL ASSETS	<u><u>\$ 57,531,577</u></u>	<u><u>\$ 62,524,885</u></u>
LIABILITIES AND NET ASSETS		
LIABILITIES	<u>\$ -</u>	<u>\$ -</u>
COMMITMENTS AND CONTINGENCY		
NET ASSETS	<u><u>\$ 57,531,577</u></u>	<u><u>\$ 62,524,885</u></u>

See independent auditor's report
See notes to financial statements

THE PROSPECT HILL FOUNDATION, INC.

**STATEMENTS OF INVESTMENT (LOSS) INCOME, EXPENSES AND
CHANGES IN NET ASSETS - MODIFIED CASH BASIS
YEARS ENDED JUNE 30, 2016 AND 2015**

	<u>2016</u>	<u>2015</u>
INVESTMENT (LOSS) INCOME		
Interest income	\$ 541	
Net partnership income	3,533,119	\$ 5,871,259
Net unrealized loss on investments	<u>(4,869,315)</u>	<u>(4,445,081)</u>
TOTAL INVESTMENT (LOSS) INCOME	<u>(1,335,655)</u>	<u>1,426,178</u>
EXPENSES		
Grants	2,766,909	3,109,829
Administrative	595,427	496,293
Investment	229,406	233,785
Excise and other taxes	<u>65,911</u>	<u>106,335</u>
TOTAL EXPENSES	<u>3,657,653</u>	<u>3,946,242</u>
DECREASE IN NET ASSETS	<u>(4,993,308)</u>	<u>(2,520,064)</u>
NET ASSETS - BEGINNING OF YEAR	<u>62,524,885</u>	<u>65,044,949</u>
NET ASSETS - END OF YEAR	<u><u>\$ 57,531,577</u></u>	<u><u>\$ 62,524,885</u></u>

See independent auditor's report
See notes to financial statements

THE PROSPECT HILL FOUNDATION, INC.

**STATEMENTS OF CASH FLOWS -
MODIFIED CASH BASIS
YEARS ENDED JUNE 30, 2016 AND 2015**

	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Decrease in net assets	\$ (4,993,308)	\$ (2,520,064)
Adjustments to reconcile change in net assets to net cash used in operating activities		
Net partnership income	(3,533,119)	(5,871,259)
Net unrealized loss on investments	4,869,315	4,445,081
Depreciation and amortization	6,095	6,333
	(3,651,017)	(3,939,909)
NET CASH USED IN OPERATING ACTIVITIES		
CASH FLOWS FROM INVESTING ACTIVITIES		
Distributions from partnerships	4,338,068	3,728,957
Program related investments	(213,000)	
	4,125,068	3,728,957
NET CASH PROVIDED BY OPERATING ACTIVITIES		
NET CHANGE IN CASH AND CASH EQUIVALENTS	474,051	(210,952)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	(25,515)	185,437
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 448,536	\$ (25,515)
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Taxes paid	\$ 65,911	\$ 106,335

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THE PROSPECT HILL FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS

1. NATURE OF ORGANIZATION

The Prospect Hill Foundation, Inc. (the “Foundation”) is a not-for-profit organization, incorporated on December 30, 1959. The mission of the Foundation is to advance the human experience while ensuring the well-being of the earth. The Foundation pursues the mission by making grants in four program sectors: Criminal Justice, Environmental Conservation, Nuclear Nonproliferation, and Reproductive Health and Rights. In addition, the Foundation makes a number of grants that support its general philanthropic interests. The Foundation’s grants primarily support activities in the United States. While many of these activities are national in scope, there is a particular regional focus in New York, Rhode Island and Massachusetts.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

The accompanying financial statements have been prepared on the cash basis of accounting modified for the presentation of investments at fair value, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. Under that basis, certain revenue and related assets are recognized when received rather than when earned, and certain expenses are recognized when paid rather than when the obligations are incurred. Consequently, the Foundation has not recognized grants payable to donees or accounts payable to vendors and their related effects on the changes in net assets in the accompanying financial statements. The Foundation does not recognize excise taxes and/or unrelated business taxes payable or deferred excise taxes and/or unrelated business taxes from unrealized gains or losses on investments.

Use of Estimates

The preparation of financial statements in conformity with the modified cash basis of accounting requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Foundation considers highly liquid investments with maturities of three months or less to be cash equivalents. The negative cash balance at June 30, 2015 is due to the timing of checks drawn and deposits made. Sufficient funds were transferred on July 2, 2015 to cover the negative book balance at June 30, 2015.

THE PROSPECT HILL FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS

Investments

The Foundation is a general partner of Prospect Capital Partners (PCP). PCP is a diversified fund of funds which invests in taxable bonds, domestic and foreign equities, absolute return and hedging strategies, real estate and energy investments, and venture capital and private investments. In addition, the Foundation's investment portfolio includes investments in venture partnerships as a limited partner.

PCP's direct holdings of investments are carried at market value, based on quoted market prices. Investments in underlying partnerships are valued based on information supplied by the management of the respective entities.

Unrealized gains and losses represent the net change in fair value during the year for investments held throughout the year, the net change in fair value from date of purchase to year-end for investments acquired during the year, and an adjustment for the accumulated unrealized appreciation (depreciation) on investments held at the end of the prior year that were sold during the current year.

The Foundation's distributive share of partnership gains and losses, interest, dividends, other income and expenses are reported as net partnership income.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are computed using the straight-line method over the estimated useful life of the related asset of five to ten years.

Risks and Uncertainties

The Foundation has cash and cash equivalents which exceed the Federal insurance limits, however, management does not believe there is any significant risk of loss on any uninsured amounts.

The Foundation's investments are subject to various risks that determine their value. Due to the level of risk associated with the investments and the level of uncertainty related to changes in the value of these investments, it is at least reasonably possible that changes in market conditions in the near term could materially affect the value reported in the financial statements.

THE PROSPECT HILL FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS

Income taxes

The Internal Revenue Code classifies the Foundation as a private foundation under Section 509(a) which is exempt from Federal income tax under Section 501(c)(3). However, the Foundation is subject to excise taxes on its net investment income and income taxes on its unrelated business taxable income. The Foundation did not pay any unrelated business tax during the years ended June 30, 2016 and 2015. The Foundation has adopted the accounting pronouncement related to income taxes which requires that a tax position be recognized based on a “more likely than not” threshold. This applies to positions taken or expected to be taken in a tax return. Management does not believe the Foundation has taken any uncertain tax positions. Management believes it is no longer subject to income tax examination for years prior to June 30, 2013.

Subsequent Events

Management has evaluated subsequent events through January __, 2017, which is the date the financial statements were available to be issued. No adjustments to the financial statements or additional disclosures are necessary.

3. PROPERTY AND EQUIPMENT

As of June 30, 2016 and 2015, property and equipment consisted of the following:

	<u>2016</u>	<u>2015</u>
Leasehold improvements	\$ 67,031	\$ 67,031
Computer equipment	27,945	27,945
Furniture and fixtures	<u>2,650</u>	<u>2,650</u>
	97,626	97,626
Less: accumulated depreciation and amortization	<u>87,296</u>	<u>81,201</u>
	<u>\$ 10,330</u>	<u>\$ 16,425</u>

THE PROSPECT HILL FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS

4. INVESTMENTS

The following schedule summarizes the relationship between cost and fair value of investments, and calculates the change in net unrealized gain on investments:

	2016	2015
Investments - 79.25% share of PCP in 2016 and 2015, respectively		
Cash and cash equivalents	\$ 3,850,660	\$ 454,341
Taxable bonds	518,866	1,311,868
Domestic equities	11,898,494	13,183,351
Foreign equities	12,146,707	14,608,214
Absolute return	12,050,077	13,656,013
Hedged equities	6,817,683	8,106,286
Real estate and energy investments	903,121	1,911,811
Venture capital - partnerships	4,766,652	5,685,868
Private equity - partnerships	2,552,291	3,391,864
	55,504,551	62,309,616
Investments - held directly		
Venture capital - partnerships	1,355,160	1,809,359
Program related investments	213,000	-
	57,072,711	64,118,975
Madoff settlement	-	(1,585,000)
Fair value, ending	57,072,711	62,533,975
Cost, ending	53,668,757	54,260,706
Unrealized appreciation, ending	3,403,954	8,273,269
Fair value, beginning	62,533,975	64,836,754
Cost, beginning	54,260,706	52,118,404
Unrealized appreciation, beginning	8,273,269	12,718,350
Net unrealized loss on investments	\$(4,869,315)	\$(4,445,081)

PCP is controlled by certain directors of the Foundation. The remaining share of PCP not owned by the Foundation is owned by another private foundation controlled by certain directors of the Foundation.

THE PROSPECT HILL FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS

5. FAIR VALUE MEASUREMENTS

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures*, provides the framework for measuring fair value. The framework provides a fair value hierarchy that prioritizes the inputs to 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 the lowest priority to unobservable inputs (Level 3 measurements). The three levels of fair value hierarchy under FASB ASC 820 are described as follows:

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

Level 2 Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in inactive markets;
- Inputs other than quoted prices that are observable for the asset or liability; and
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specific (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

Inputs broadly refer to the assumptions that market participants use to make valuation decisions, including assumptions about risk. The Foundation generally uses the capital balance reported by the investee fund manager as the primary input to its valuation; however, adjustments to the reported capital balance may be made based on various factors, including, but not limited to, the attributes of the interest held, including the rights and obligations, any restrictions on illiquidity of such interests, and the fair value of the fund's investment portfolio or other assets and liabilities.

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NOTES TO FINANCIAL STATEMENTS

An investment’s level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. However, the determination of what constitutes “observable” requires significant judgment by management. Management considers observable data to be that market data which is readily available, regularly distributed or updated, reliable and verifiable, not proprietary, and provided by multiple, independent sources that are actively involved in the relevant market. The categorization of an investment within the hierarchy is based upon the pricing transparency of that investment and does not necessarily correspond to management’s perceived risk of that investment.

Investments are carried at fair value measured on a recurring basis. As of June 30, 2016 and 2015 investments are as follows:

Assets at Fair Value as of June 30, 2016				
	Level 1	Level 2	Level 3	Total
Held directly				
Venture capital - partnerships			\$ 1,355,160	\$ 1,355,160
Program related investments			213,000	213,000
Held by PCP				
Cash and cash equivalents	\$ 3,850,660			3,850,660
Taxable bonds		\$ 518,866		518,866
Domestic equities	9,564,550		2,333,944	11,898,494
Foreign equities	1,484,890	2,852,120	7,809,697	12,146,707
Absolute return			12,050,077	12,050,077
Hedged equities			6,817,683	6,817,683
Real estate and energy investments			903,121	903,121
Venture capital - partnerships			4,766,652	4,766,652
Private equity - partnerships			2,552,291	2,552,291
Total investments	<u>\$14,900,100</u>	<u>\$ 3,370,986</u>	<u>\$38,801,625</u>	<u>\$57,072,711</u>

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NOTES TO FINANCIAL STATEMENTS

	Assets at Fair Value as of June 30, 2015			
	Level 1	Level 2	Level 3	Total
Held directly				
Venture capital - partnerships			\$ 1,809,359	\$ 1,809,359
Held by PCP				
Cash and cash equivalents	\$ 454,341			454,341
Taxable bonds		\$ 1,311,868		1,311,868
Domestic equities	10,950,673		2,232,678	13,183,351
Foreign equities	3,308,976	2,882,353	8,416,885	14,608,214
Absolute return			13,656,013	13,656,013
Hedged equities			8,106,286	8,106,286
Real estate and energy investments			1,911,811	1,911,811
Venture capital - partnerships			5,685,868	5,685,868
Private equity - partnerships			3,391,864	3,391,864
Total investments	<u>\$14,713,990</u>	<u>\$4,194,221</u>	<u>\$45,210,764</u>	<u>\$64,118,975</u>

The following table summarizes the changes in fair values associated with FASB ASC 820 Level 3 assets:

	Investments held directly	Investments held by PCP	Total
Balance at June 30, 2015	\$ 1,809,359	\$43,401,405	\$45,210,764
Purchases	213,000	3,939,560	4,152,560
Realizations	(375,568)	(9,001,266)	(9,376,834)
Gains			
Realized		(1,080,891)	(1,080,891)
Unrealized	<u>(78,631)</u>	<u>(25,343)</u>	<u>(103,974)</u>
Balance at June 30, 2016	<u>\$ 1,568,160</u>	<u>\$37,233,465</u>	<u>\$38,801,625</u>

6. RELATED PARTY TRANSACTIONS

Pursuant to service agreements during the years ended June 30, 2016 and 2015, the Foundation paid \$549,296 and \$534,576, respectively, to an affiliated organization as reimbursement for salaries, profit sharing plan contributions, payroll related expenses and other costs incurred on the Foundation's behalf. The beneficial owners of the affiliate are officers and/or directors of the Foundation.

THE PROSPECT HILL FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS

7. COMMITMENTS

Lease

The Foundation occupies offices at 99 Park Avenue, New York, New York, under an operating lease which expires on May 31, 2018. The lease provides for escalation charges based upon increases in real estate taxes and certain operating costs. Rent expense was \$72,611 and \$72,723 for the years ended June 30, 2016 and 2015, respectively.

Future minimum annual lease payments are as follows:

<u>Years Ending June 30,</u>	
2017	66,750
2018	<u>61,188</u>
Total	<u>\$127,938</u>

Investments

The Foundation has commitments to invest \$8,597,500 in limited partnerships. As of June 30, 2016, \$8,550,000 has been invested, leaving an unfunded balance of \$47,500.

Grants

As of June 30, 2016, the Foundation is committed to making eighteen grants in future years in the aggregate amount of \$1,619,500.

Minimum Distribution Requirements

The Internal Revenue Code requires that foundations make certain minimum charitable distributions each year under a specified formula which amounts to approximately 5% of the average fair market value of the Foundation's previous year's net assets. The Foundation has an excess distributions carryover totaling \$2,947,319 which arose in the fiscal years ended 2012 through 2016. The carryover can be used to help satisfy the minimum distribution requirement prior to expiration over a five-year period from the fiscal years ended 2017 through 2021.

THE PROSPECT HILL FOUNDATION, INC.

NOTES TO FINANCIAL STATEMENTS

8. MADOFF SETTLEMENT

On November 12, 2010, an adversary proceeding was filed by the Trustee for the liquidation of Bernard L. Madoff Investment Securities LLC against the Foundation for distributions received by PCP between 2006 and 2008 in the aggregate amount of \$2,000,000. On December 30, 2015, the Foundation settled this matter and PCP returned \$2,000,000 back to the bankruptcy trustee. The Foundation's investment in PCP has been written down by \$1,585,000 as of June 30, 2015 to reflect its share of the PCP payment made.