

MONTANA HEALTHCARE FOUNDATION

Financial Statements

For the Year Ended December 31, 2016

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Independent Auditor's Report

To the Board of Trustees of Montana Healthcare Foundation Bozeman, Montana

We have audited the accompanying financial statements of Montana Healthcare Foundation (the Foundation), which comprise the statement of financial position as of December 31, 2016, and the related statements of activities and change in net assets 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.

Auditor's 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 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.



T: 425-454-4919
T: 800-504-8747
F: 425-454-4620

10900 NE 4th St
Suite 1700
Bellevue WA
98004

clarknuber.com

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Foundation as of December 31, 2016, and the change 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.

Clark Nuber P.S.

Certified Public Accountants
May 11, 2017

MONTANA HEALTHCARE FOUNDATION

**Statement of Financial Position
December 31, 2016**

Assets:

Cash and cash equivalents	\$ 15,761,635
Investments	120,732,727
Prepays and other assets	<u>93,720</u>

Total Assets \$ 136,588,082

Liabilities and Net Assets

Liabilities:

Accounts payable and accrued liabilities	\$ 37,465
Grants payable	<u>964,711</u>

Total Liabilities **1,002,176**

Net Assets:

Unrestricted	132,585,906
Temporarily restricted	<u>3,000,000</u>

Total Net Assets 135,585,906

Total Liabilities and Net Assets \$ 136,588,082

MONTANA HEALTHCARE FOUNDATION

**Statement of Activities and Changes in Net Assets
For the Year Ended December 31, 2016**

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
Revenues, Gains and Other Support:			
Grants and contributions	\$ 30,000,000	\$ 3,000,000	\$ 33,000,000
Interest and dividends	1,311,651		1,311,651
Realized and unrealized gains on investments	4,552,636		4,552,636
Other income	50,000		50,000
	<u>35,914,287</u>	<u>3,000,000</u>	<u>38,914,287</u>
Total Revenues, Gains and Other Support			
Expenses:			
Program services-			
Grants	3,392,691		3,392,691
Other program related expenses	528,995		528,995
	<u>3,921,686</u>		<u>3,921,686</u>
Total program expenses			
Management and general-			
Investment related expenses	391,728		391,728
Administrative	405,105		405,105
	<u>796,833</u>		<u>796,833</u>
Total management and general			
Total Expenses	<u>4,718,519</u>		<u>4,718,519</u>
Change in Net Assets	31,195,768	3,000,000	34,195,768
Net assets, beginning of year	101,390,138		101,390,138
Net Assets, End of Year	<u><u>\$ 132,585,906</u></u>	<u><u>\$ 3,000,000</u></u>	<u><u>\$ 135,585,906</u></u>

See accompanying notes.

MONTANA HEALTHCARE FOUNDATION

**Statement of Cash Flows
For the Year Ended December 31, 2016**

Cash Flows From Operating Activities:

Change in net assets	\$ 34,195,768
Adjustments to reconcile change in net assets to net cash provided by operating activities-	
Realized and unrealized gains on investments	(4,552,636)
Changes in assets and liabilities:	
Prepaid expenses and other assets	(18,962)
Accounts payable and accrued liabilities	(12,694)
Grants payable	134,971

Net Cash Provided by Operating Activities **29,746,447**

Cash Flows From Investing Activities:

Purchase of investments	(31,277,849)
Proceeds from sale of investments	10,092,463

Net Cash Used by Investing Activities **(21,185,386)**

Net Change in Cash and Cash Equivalents **8,561,061**

Cash and cash equivalents, beginning of year 7,200,574

Cash and Cash Equivalents, End of Year **\$ 15,761,635**

Supplementary Disclosure of Cash Flow Information:

Cash paid during the year for excise taxes \$ 10,760

MONTANA HEALTHCARE FOUNDATION

Notes to Financial Statements For the Year Ended December 31, 2016

Note 1 - Nature of Activities and Significant Accounting Policies

Nature of Activities - Montana Healthcare Foundation (the Foundation), which was established in 2013, came into existence as result of the sale of Blue Cross & Blue Shield of Montana to a private corporation. In accordance with State law, the assets were transferred to a charitable trust to be managed for public benefit. The Foundation is a permanent resource for Montanans. Rather than spending the money in the trust over a few years and then dissolving, the Foundation will spend the income from trust investments (approximately five percent of the total value of the trust each year), and provide a stable, reliable resource supporting health for Montanans.

The Foundation makes strategic investments to improve the health and well-being of all Montanans. It envisions a measurably healthier State through improving access to quality and affordable health services, evidence-based health education, research and analysis, improving the upstream influences on health and illnesses and informed public policy. The Foundation is committed to upholding this promise to the residents of Montana and being governed by the guiding principle that everyone benefits from better health.

Certain people in the state of Montana face particularly difficult challenges to health. Health disparities, defined as the higher rates of illness and death that are consistently documented among certain subgroups, are all too common among certain racial and ethnic groups, among those who face social and economic disadvantage and among young children and older adults. Across all of their work, the Foundation places a particular emphasis on reducing health disparities, and ensuring that every Montanan has an opportunity to enjoy a full, productive and healthy life.

A summary of the Foundation's significant accounting policies follows:

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

Unrestricted Net Assets - Net assets that are not subject to externally imposed restrictions. Changes in this category of net assets include restricted contributions whose donor-imposed restrictions were met during the fiscal year. The Foundation has designated \$40.2 million of its unrestricted net assets as a quasi-endowment.

Temporarily Restricted Net Assets - Net assets subject to externally imposed restrictions that may or will be met either by actions of the Foundation and/or the passage of time.

Permanently Restricted Net Assets - Permanently restricted net assets include all of the Foundation's net assets received by donations wherein the donors imposed a permanent restriction on the use of the gift. There were no permanently restricted net assets as of December 31, 2016.

Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law. Expirations of temporary restrictions on net assets are reported as transfers between the applicable classes of net assets.

Contributions - Contributions are recognized as revenues in the period received.

MONTANA HEALTHCARE FOUNDATION

Notes to Financial Statements For the Year Ended December 31, 2016

Note 1 - Continued

Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) 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, as well as the reported amounts of revenues and expenses, including functional allocations, during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents - For purposes of the statement of cash flows, the Foundation considers all cash and other highly liquid investments with initial maturities of three months or less to be cash equivalents, other than those included in the investment portfolio.

Investments - Investments in money market and mutual funds are measured at fair value based on published quotations. The Foundation's private investments are valued using net asset value (NAV) provided by the general partner or investment manager of the partnerships based on factors deemed relevant by the respective general partner or investment manager. Management conducts its own due diligence on the factors used by the general partner or investment manager of these partnerships and agrees with the valuation methods and assumptions used in determining the fair values of the investments. All gains or losses are recorded in the statement of activities and changes in net assets as increases or decreases in unrestricted net assets, unless their use is temporarily restricted by explicit donor restrictions or law.

Investments are made according to the Investment Policy Statement adopted by the Foundation's Board of Trustees. These guidelines provide for investments in equities, fixed income, emerging markets and other investments with performance measured against appropriate indices. Outside parties are contracted with by the Foundation for the purpose of providing investment management and consulting.

Investment securities, in general, are exposed to various risks, including interest rate, credit and overall market volatility. Due to the level of risk associated with certain long-term investments, it is reasonably probable that changes in the values of these investments will occur in the near term and that such changes could materially affect the amounts reported in the balance sheets.

Dividend income is recorded on the ex-dividend date. Interest income is recorded on an accrual basis when earned.

Concentrations - Financial instruments that potentially subject the Foundation to concentrations of credit and market risk consist primarily of cash and investments. Cash and investments held by financial institutions exceed federally insured limits. Management anticipates no material effect to the Foundation's financial position as a result of these concentrations.

For the year ended December 31, 2016, 100% of the Foundation's contribution and grant funding came from two organizations.

Grants - Grants made and unconditional promises to make future grants are recognized the earlier of when made or when the promise is conveyed. Grants payable over more than one year are recorded at their discounted present value using a risk adjusted rate of return. Changes in discounts are recognized over the period of the promise as adjustments to grant expenses.

Functional Allocation of Expenses - The cost of providing the various programs and other activities has been summarized on a functional basis in the statement of activities and changes in net assets. Accordingly, certain costs have been allocated among the programs and supporting services benefitted.

MONTANA HEALTHCARE FOUNDATION

**Notes to Financial Statements
For the Year Ended December 31, 2016**

Note 1 - Continued

Subsequent Events - The Foundation's management has evaluated subsequent events through May 11, 2017 the date on which the financial statements were available to be issued.

Note 2 - Excise Taxes and Required Charitable Grants

The Foundation has obtained tax-exempt status from federal income tax under Section 501(c)(3) of the Internal Revenue Code (IRC). However, the Foundation is a private foundation as defined in the IRC, and is therefore subject to an excise tax on its net investment income.

The Foundation is also required under the IRC to make minimum charitable distributions based on the fair value of its assets. Charitable distributions made in excess of the required minimum in any year may be used to reduce the minimum distributions required in future years, subject to a five-year carryover limitation. Failure to make the minimum charitable distributions could result in additional taxes and possible penalties.

Note 3 - Investments

Investments consisted of the following at December 31, 2016:

Investments valued at fair value based on market quotes-	
Money markets	\$ 12,510,629
Bond mutual fund	20,258,898
Equity mutual funds	<u>51,310,942</u>
	84,080,469
Nonmarketable securities	<u>36,652,258</u>
Total Investments	<u><u>\$ 120,732,727</u></u>

Investment return consisted of the following for the year ended December 31, 2016:

Interest and dividends	\$ 1,311,651
Realized and unrealized gains on investments	<u>4,552,636</u>
Total Investment Return	<u><u>\$ 5,864,287</u></u>

Investment management fees totaled \$317,116 for the year ended December 31, 2016.

MONTANA HEALTHCARE FOUNDATION

Notes to Financial Statements For the Year Ended December 31, 2016

Note 4 - Fair Value Measurements

U.S. GAAP has established a framework that requires fair value to be determined based on the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants.

To increase consistency and comparability in fair value measurements, U.S. GAAP uses a fair value hierarchy which prioritizes the inputs to valuation approaches into three broad levels based on observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Foundation's market assumptions. These two types of inputs create the following fair value hierarchy:

Level 1 - Inputs are unadjusted and represent quoted prices in active markets for identical assets at the measurement date;

Level 2 - Inputs are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in inactive markets, and model-derived valuations whose inputs are observable; or

Level 3 - Inputs are unobservable and reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date. Consideration is given to the risk inherent in the valuation technique and/or the risk inherent in the inputs to the model.

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at December 31, 2016.

Money Markets - Money market funds are valued at cost plus accrued interest, which approximates fair value.

Bond and Equity Mutual Funds - Valued at the closing price reported on the active market in which the securities are traded.

Nonmarketable Securities - Valued at the NAV as reported by the general partner or investment manager unless specific evidence indicates that NAV should be adjusted. This may involve significant unobservable inputs. The valuation methods utilized by the investment managers are subject to regular review by the Foundation.

Management determines the Foundation's fair value measurements valuation policies and procedures, including those reported at NAV. The Foundation's Board of Trustees assesses and approves these policies and procedures.

During the year ended December 31, 2016, the Foundation implemented ASU 2015-07, *Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share (or its Equivalent)*, which removes the requirement that investments for which fair value is measured using the NAV per share, or its equivalent, be categorized in the fair value hierarchy. The fair value amounts presented in the tables below are intended to permit reconciliation of the fair value hierarchy to the line items presented in the statement of financial position.

MONTANA HEALTHCARE FOUNDATION

**Notes to Financial Statements
For the Year Ended December 31, 2016**

Note 4 - Continued

Fair values of assets measured on a recurring basis were as follows as of December 31, 2016:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Money markets	\$ 12,510,629	\$ -	\$ -	\$ 12,510,629
Bond mutual fund	20,258,898			20,258,898
Equity mutual funds-				
U.S large cap	27,424,924			27,424,924
U.S small cap	8,108,112			8,108,112
International	15,777,906			15,777,906
Total Investments in the Fair Value Hierarchy	<u>\$ 84,080,469</u>	<u>\$ -</u>	<u>\$ -</u>	84,080,469
Investments measured at NAV				<u>36,652,258</u>
Total Investments at Fair Value				<u>\$ 120,732,727</u>

The table below summarizes significant terms of the agreements with certain investment companies for nonmarketable investments. There are no significant redemption restrictions or unfunded commitments on other types of investments.

<u>Asset Class</u>	<u>Fair Value December 31, 2016</u>	<u>Unfunded Commitments</u>	<u>Redemption Frequency</u>	<u>Redemption Notice Period</u>	<u>Other Restrictions</u>
Hedge funds*	\$ 10,031,495	\$ -	Monthly - 3 years	30 days	None
Offshore corporation	9,312,691		Monthly	30 days	None
Partnership & trust	17,308,072		Monthly	7 - 30 days	None
	<u>\$ 36,652,258</u>	<u>\$ -</u>			

* One of the funds included here is in the process of liquidation as of December 31, 2016.

Note 5 - Grants Payable

Grants authorized but unpaid at year-end are reported as liabilities. Grants authorized are payable as follows:

For the Year Ending December 31,

2017	<u>\$ 964,711</u>
	<u>\$ 964,711</u>

MONTANA HEALTHCARE FOUNDATION

**Notes to Financial Statements
For the Year Ended December 31, 2016**

Note 5 - Continued

There were no conditional grants authorized as of December 31, 2016. There is no discount to present value as of December 31, 2016, as all grants are payable in the next year.

Note 6 - Temporarily Restricted Net Assets

As of December 31, 2016, temporarily restricted net assets consisted of one contribution restricted for use related to improving substance abuse prevention and treatment in Montana.

Note 7 - Commitments

Operating Lease - The Foundation entered into a lease for office space that began August 14, 2014, and terminates on April 14, 2020. Monthly payments began at \$1,869 and increase to \$2,103 over the term of the lease. Future minimum lease payments are as follows:

For the Year Ending December 31,

2017	\$	46,029
2018		47,130
2019		47,832
2020		<u>14,011</u>
	\$	<u><u>155,002</u></u>

Rental expense for the year ended December 31, 2016 totaled \$63,844.

Employment Agreement - Effective January 1, 2017, the Foundation entered into an employment agreement with a key member of management that expires on December 31, 2021. The agreement would require a final payout to the employee for the Foundation to terminate the agreement prior to expiration without good cause.

Note 8 - Retirement Plan

The Foundation has established a SIMPLE IRA Plan. All employees are eligible with enrollment at the start of each calendar year. The Foundation matches up to 100% of employees' contributions up to 3% of participants' eligible compensation. Matching expense totaled \$13,010 for the year ended December 31, 2016.

Note 9 - Related Party Transactions

The Foundation paid stipends totaling \$144,000 to Board Trustees during the year ended December 31, 2016.

MONTANA HEALTHCARE FOUNDATION

**Notes to Financial Statements
For the Year Ended December 31, 2016**

Note 10 - Quasi-Endowment

During the year ended December 31, 2016, the Foundation established a quasi-endowment to preserve the initial \$40,200,000 of assets transferred to the Foundation upon formation.

Return Objectives and Risk Parameters - The Foundation has adopted investment policies for endowment assets that attempts to earn a return that preserves the trust assets in perpetuity and maximizes the income available to fulfill the Foundation's charitable purpose. The endowment assets are diversified among several asset classes to achieve the Foundation's return goal while maintaining acceptable levels of risk.

Strategies Employed for Achieving Objectives - To satisfy its long-term return goal, the Foundation relies on a total return strategy in which investment returns are achieved through both income and net realized and unrealized capital gains. The Foundation targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return goal.

Spending Policy - The Foundation's policy for its quasi-endowment is to spend 5% of a rolling 12 quarter average of the endowment balance. Beginning in 2017, the Foundation will allocate investment earnings related to the quasi-endowment.