

Cone Health Foundation

Financial Statements as of and for the
Years Ended September 30, 2017 and 2016,
and Independent Auditors' Report

CONE HEALTH FOUNDATION

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Cone Health Foundation:

We have audited the accompanying financial statements of Cone Health Foundation (the "Foundation"), which comprise the statements of financial position as of September 30, 2017 and 2016, and the related statements of activities and changes in net assets and cash flows 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 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 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 Foundation'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 Foundation'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 Foundation as of September 30, 2017 and 2016, and the results of its activities and changes in net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

February 1, 2018

CONE HEALTH FOUNDATION

**STATEMENTS OF FINANCIAL POSITION
AS OF SEPTEMBER 30, 2017 AND 2016**

	2017	2016
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 1,767,953	\$ 978,626
Investments—short term		420,655
Other current assets	<u>406</u>	<u>462</u>
Total current assets	1,768,359	1,399,743
INVESTMENTS—long term	<u>109,106,673</u>	<u>104,082,679</u>
TOTAL	<u>\$ 110,875,032</u>	<u>\$ 105,482,422</u>
 LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Grants payable—current	\$ 4,658,292	\$ 4,311,506
Accounts payable and accrued expenses	<u>144,873</u>	<u>144,652</u>
Total current liabilities	4,803,165	4,456,158
GRANTS PAYABLE—net of current portion	<u>400,000</u>	<u>4,735,791</u>
Total liabilities	5,203,165	9,191,949
UNRESTRICTED NET ASSETS	<u>105,671,867</u>	<u>96,290,473</u>
TOTAL	<u>\$ 110,875,032</u>	<u>\$ 105,482,422</u>

See notes to financial statements.

CONE HEALTH FOUNDATION

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS FOR THE YEARS ENDED SEPTEMBER 30, 2017 AND 2016

	2017	2016
INCOME:		
Dividends and interest	\$ 1,603,661	\$ 2,061,285
Realized and unrealized gains on investments	10,136,143	7,286,828
Other operating revenue	<u>573</u>	<u>135</u>
Total income	<u>11,740,377</u>	<u>9,348,248</u>
EXPENSES:		
Grants awarded	283,748	480,056
Contributions made	36,025	29,700
Salaries and benefits	815,930	819,563
Investment management fees	848,250	723,161
General and administrative expenses	219,713	209,686
Consulting fees	<u>155,317</u>	<u>152,838</u>
Total expenses	<u>2,358,983</u>	<u>2,415,004</u>
CHANGE IN UNRESTRICTED NET ASSETS	9,381,394	6,933,244
NET ASSETS—Beginning of year	<u>96,290,473</u>	<u>89,357,229</u>
NET ASSETS—End of year	<u>\$ 105,671,867</u>	<u>\$ 96,290,473</u>

See notes to financial statements.

CONE HEALTH FOUNDATION

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED SEPTEMBER 30, 2017 AND 2016

	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	\$ 9,381,394	\$ 6,933,244
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Change in unrealized gains on investments—net	(6,421,410)	(2,491,037)
Net realized gains on sale of investments	(3,714,733)	(4,795,791)
Purchase of trading securities		(5,689,724)
Proceeds from sale of trading securities		6,738,662
Changes in:		
Other assets	56	(363)
Grants payable	(3,989,005)	(4,431,528)
Accounts payable and accrued expenses	<u>221</u>	<u>(2,294)</u>
Net cash used in operating activities	<u>(4,743,477)</u>	<u>(3,738,831)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investments	(30,820,332)	(8,305,218)
Sale of investments	<u>36,353,136</u>	<u>12,135,176</u>
Net cash provided by investing activities	<u>5,532,804</u>	<u>3,829,958</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	789,327	91,127
CASH AND CASH EQUIVALENTS:		
Beginning of year	<u>978,626</u>	<u>887,499</u>
End of year	<u>\$ 1,767,953</u>	<u>\$ 978,626</u>

See notes to financial statements.

CONE HEALTH FOUNDATION

NOTES TO FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED SEPTEMBER 30, 2017 AND 2016

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization—The Moses Cone—Wesley Long Community Health Foundation, Inc. (dba Cone Health Foundation) (the "Foundation") was incorporated on December 2, 1996, as a North Carolina nonprofit corporation by Wesley Long Community Hospital. On October 1, 1997, the Wesley Long Community Hospital and The Moses H. Cone Memorial Hospital merged. An outcome of the merger was the consolidation of the community health program of the Moses Cone Health System (the "Health System") with the Foundation. The purpose of the Foundation is to invest in the development and support of activities, programs, and organizations that measurably improve the health of people in the greater Greensboro Area. The Foundation is a 509(a)(3) supporting organization of the Health System.

The Foundation's board of directors (the "Board of Directors") has sole authority over the disbursements of net assets and consists of 17 members, with 10 directors elected by the governing board of The Moses H. Cone Memorial Hospital and seven directors elected by the Cone Health Foundation Board.

Use of Estimates—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (US GAAP) 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 date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates.

Risks and Uncertainties—The Foundation invests in debt and equity investment securities that are exposed to various risks, such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the value of investment securities, it is at least reasonably possible that changes in risks in the near term would materially affect the investment balances in the financial statements.

Cash and Cash Equivalents—Cash and cash equivalents are held in the Foundation's operating bank account and include demand deposits and certain investments in highly liquid debt instruments with original maturities at the time of purchase of three months or less.

Investments—Investment assets of the Foundation are to be used at the direction of the Board of Directors to accomplish the stated purpose of the Foundation. Investments in equity securities with readily determinable fair values, investments in common/commingled/collective trusts, and all investments in debt securities are measured at fair value in the accompanying balance sheets. Interest, dividends, and realized and unrealized gains and losses on investments are included in income in the accompanying statements of activities and changes in net assets. Interests in alternative investments, whose operating and financial policies the Foundation's management has virtually no influence over, are measured at cost in the accompanying statements of financial position.

During fiscal year 2017, the Foundation's management reassessed its investments held in managed accounts and determined that the securities held in these accounts are not intended to be sold within hours or days, but rather to maximize portfolio returns, and therefore these securities were appropriately transferred from trading investments to available-for-sale investments.

Fair Value Measurements—US GAAP defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. Additionally, the inputs used to measure fair value are prioritized based on a three-level hierarchy. This hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

Level 1—Valuations based on unadjusted quoted prices for identical instruments in active markets that are available as of the measurement date

Level 2—Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly

Level 3—Valuations based on inputs that are unobservable and significant to the overall fair value measurement

US GAAP permits, as a practical expedient, a reporting entity to measure the fair value of certain investments without readily determinable fair values by using the reported net asset value (NAV) per share of the investment without further adjustment if the investment is in an entity that meets the description of an investment company whose underlying investments are measured at fair value as set forth in the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC).

The fair values of investments in common/commingled/collective trusts, which are recorded at fair value in the statements of financial position, and alternative investments, which are recorded at cost in the statements of financial position and disclosed at fair value in Note 2, are measured using the NAV per share reported by the respective fund managers or the general partners.

The estimated fair values of certain alternative investments, such as private equity interests, are based on valuations performed prior to the balance sheet date by the external investment managers and adjusted for cash receipts, cash disbursements, and securities distributions through September 30. Because alternative investments are not readily marketable, their estimated fair value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for such investments existed. Such differences could be material.

The Foundation's management, with the assistance of a third-party investment consultant, where appropriate, evaluates the NAV information and valuations provided by external fund managers or general partners for appropriateness through review of the most recently available annual audited financial statements and unaudited interim reporting for the respective funds, review of the methodologies used to determine fair value, and comparisons of fund performance to market benchmarks.

The carrying amounts of cash equivalents, accounts payable, and grants payable approximates fair value based on the nature and short duration of these accounts.

Transfers between Levels—The availability of market observable data is monitored to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or valuation methodologies may require the transfer of financial instruments from one fair value hierarchy level to another. In such instances, the transfer would be reported at the beginning of the reporting period. The Foundation evaluates the significance of transfers based on the nature of the financial instrument and the size of the transfer. There were no transfers of investments between levels for the years ended September 30, 2017 and 2016.

Grant Expense—The Foundation records grants as expense in the fiscal year in which the grants are authorized by the Board of Directors and pledged to the recipient. In 2015, the Foundation awarded three-year grants in all four of its priority areas for the first time. Single-year grants may be issued at the board’s discretion.

Income Taxes—The Foundation is organized as a corporation exempt from federal and state income taxes under Internal Revenue Code Section 501(c)(3) and North Carolina laws.

Subsequent Events—The Foundation has evaluated events and transactions occurring after September 30, 2017, and through the date these financial statements were available to be issued for potential recognition or disclosure. No events or transactions were identified that would require recognition or disclosure in the financial statements.

Recently Issued Accounting Guidance—In January 2016, the FASB issued Accounting Standards Update (ASU) No. 2016-01, *Financial Instruments—Overall (Topic 825-10) Recognition and Measurement of Financial Assets and Financial Liabilities* (“ASU 2016-01”). ASU 2016-01 revises an entity’s accounting related to (1) the classification and measurement of investments in equity securities and (2) the presentation of certain fair value changes for financial liabilities measured at fair value. It also amends certain disclosure requirements associated with the fair value of financial instruments. ASU 2016-01 is effective for fiscal years beginning after December 15, 2018. The Foundation is currently evaluating the provisions of this update and their impact on its financial statements.

In August 2016, the FASB issued ASU No. 2016-14, *Not-for-Profit Entities—Presentation of Financial Statements of Not-for-Profit Entities*, which supersedes existing guidance in FASB ASC 958, *Not-for-Profit Entities*, to improve the current net asset classification requirements and the information presented in the financial statements and related notes about a not-for-profit entity’s (NFP’s) liquidity, financial performance, and cash flows. The guidance is effective for NFPs with annual periods beginning after December 15, 2017. The Foundation is currently evaluating the provisions of this update and their impact on its financial statements.

2. INVESTMENTS

At September 30, 2017, the composition of the Foundation's long-term investments is as follows:

	Fair Value Measurement Using			Total
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Fixed-income funds and securities	\$ 15,705,251	\$ 8,349,082	\$ -	\$ 24,054,333
US equity funds and securities	<u>8,661,878</u>			<u>8,661,878</u>
Subtotal	<u>\$ 24,367,129</u>	<u>\$ 8,349,082</u>	<u>\$ -</u>	<u>32,716,211</u>
Investments measured at net asset value:				
Equity securities				7,499,240
International equity securities				<u>34,580,251</u>
Commodity securities				<u>4,138,405</u>
Subtotal				<u>46,217,896</u>
Alternative investments measured at cost				<u>30,172,566</u>
Total				<u>\$ 109,106,673</u>

At September 30, 2016, the composition of the Foundation's long-term investments is as follows:

	Fair Value Measurement Using			Total
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Fixed-income funds and securities	\$ 11,468,842	\$ 8,486,681	\$ -	\$ 19,955,523
US equity funds and securities	<u>7,769,246</u>			<u>7,769,246</u>
Subtotal	<u>\$ 19,238,088</u>	<u>\$ 8,486,681</u>	<u>\$ -</u>	<u>27,724,769</u>
Investments measured at net asset value:				
Equity securities				7,092,764
International equity securities				26,720,234
Emerging market funds				5,465,330
Commodity securities				<u>2,100,412</u>
Subtotal				<u>41,378,740</u>
Alternative investments measured at cost				<u>34,979,170</u>
Total				<u>\$ 104,082,679</u>

Alternative investments include limited partnerships, limited liability corporations, and offshore investments funds. Included in investments of the limited partnerships are certain types of financial instruments, including, among others, futures and forward contracts, options, and securities sold not yet purchased, intended to hedge against changes in the

market value of investments. These financial instruments, which involve varying degrees of off-balance-sheet risk, may result in loss due to changes in the market (market risk). Alternative investments are less liquid compared to the Foundation's other investments.

A summary of the Foundation's alternative investments recorded at cost within long-term investments at September 30, 2017 and 2016, is as follows:

	2017		2016	
	Cost	Estimated Fair Value	Cost	Estimated Fair Value
Private equity funds	\$ 8,250,416	\$ 9,970,605	\$ 5,519,318	\$ 7,097,168
Private debt funds	4,789,351	5,352,401	4,588,076	4,651,047
Hedge funds	17,132,799	19,995,766	17,491,091	19,634,301
Risk parity funds			5,684,178	6,715,216
Real estate funds			1,696,507	2,798,109
	<u>\$30,172,566</u>	<u>\$35,318,772</u>	<u>\$34,979,170</u>	<u>\$40,895,841</u>

A summary of the investments with a reported NAV recorded within investments as of September 30, 2017, is as follows:

	Fair Value	Unfunded Commitment	Redemption Frequency	Redemption Notice Period
Investments in common, commingled, and collective trust funds:				
Equity securities	\$ 41,006,191	\$	Daily, semi-monthly, and monthly	1 day to 30 days
Equity securities	1,073,300		End of any calendar quarter	65 days
Commodity securities	4,138,405		Daily and monthly	None to 35 days
	<u>\$ 46,217,896</u>	<u>\$</u>		
Alternative investment funds:				
Private equity	\$ 9,970,605	\$ 6,407,680	N/A—Illiquid	N/A—Illiquid
Private debt	5,028,498	1,650,366	N/A—Illiquid	N/A—Illiquid
Private debt	323,903		Quarterly	60 days to 90 days
Hedge funds	7,954,998		Monthly and quarterly	30 days to 90 days
Hedge funds	12,040,768		Daily, monthly, and quarterly	1 day to 90 days
	<u>\$ 35,318,772</u>	<u>\$ 8,058,046</u>		

A summary of the investments with a reported NAV recorded within investments as of September 30, 2016, is as follows:

	Fair Value	Unfunded Commitment	Redemption Frequency	Redemption Notice Period
Investments in common, comingled, and collective trust funds:				
Equity securities	\$ 32,400,402	\$ -	Daily, semi-monthly, and monthly	1 day to 30 days
Equity securities	1,412,596		End of any calendar quarter	65 days
Emerging market funds	5,465,330		Daily and monthly	1 day to 30 days
Commodity securities	<u>2,100,412</u>		Daily and monthly	None to 35 days
	<u>\$ 41,378,740</u>	<u>\$ -</u>		
Alternative investment funds:				
Private equity	\$ 7,097,168	\$ 9,524,120	N/A—Illiquid	N/A—Illiquid
Private debt	4,166,197	5,690,431	N/A—Illiquid	N/A—Illiquid
Private debt	484,850	472,775	Quarterly	60 days to 90 days
Hedge funds	12,058,589		Monthly and quarterly	30 days to 90 days
Hedge funds	7,575,712		Daily, monthly, and quarterly	1 day to 90 days
Risk parity	6,715,216		Monthly	15 days
Real estate	<u>2,798,109</u>		Quarterly	90 days
	<u>\$ 40,895,841</u>	<u>\$ 15,687,326</u>		

Investment income and gains and losses for the years ended September 30, 2017 and 2016, consist of the following:

	2017	2016
Dividend and interest income	\$ 1,603,661	\$ 2,061,285
Realized gains on sales of securities—net	3,714,733	4,795,791
Change in unrealized gains on investments—net	<u>6,421,410</u>	<u>2,491,037</u>
	<u>\$ 11,739,804</u>	<u>\$ 9,348,113</u>

3. TRANSACTIONS WITH THE HEALTH SYSTEM

The Health System performs certain administrative functions for the Foundation. Funds disbursed on behalf of the Foundation are reimbursed to the Health System. The total amount of expenses paid by the Health System and reimbursed by the Foundation for the years ended September 30, 2017 and 2016, were \$981,436 and \$1,088,808, respectively. As of September 30, 2017 and 2016, amounts due to the Health System related to these services totaled \$50,286 and \$49,761, respectively, reflected in accounts payable and accrued expenses within the statements of financial position.

The Foundation leases its office space from the Health System for a defined amount each year with an indefinite lease term. The lease expense is based on the square footage occupied, plus a prorated share of allocated costs, such as janitorial services, utilities, and facility management. The lease expense was \$48,937 and \$42,725 for the years ended September 30, 2017 and 2016, respectively.

The Foundation and the Health System are obligated parties under the Health System's Master Trust Indenture. As of September 30, 2017 and 2016, outstanding bonds under this Master Trust Indenture totaled \$476,465,000 and \$438,895,000, respectively.

Grant expense at September 30, 2017, included \$37,500 funds granted to the Health System. At September 30, 2016, grant expense did not include any funds granted to the Health System. Grants payable as of September 30, 2017 and 2016, due to the Health System was \$576,063 and \$894,099, respectively.

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