

MICHIGAN HEALTH ENDOWMENT FUND  
(A Michigan Non-Profit Corporation)

**FINANCIAL STATEMENTS**

**December 31, 2014**



MICHIGAN HEALTH ENDOWMENT FUND  
(A Michigan Non-Profit Corporation)

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## **INDEPENDENT AUDITOR'S REPORT**

September 23, 2015

To the Board of Directors  
Michigan Health Endowment Fund

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the Michigan Health Endowment Fund (the "Fund," a Michigan non-profit Corporation), which comprise the statement of financial position as of December 31, 2014, and the related statements of activities and cash flows for the year then ended, as well as the related notes to the financial statements.

### **Management's Responsibility for the Financial Statements**

The Fund's 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 Fund'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 Fund's internal control. Accordingly, we express no such opinion.

Board of Directors  
Michigan Health Endowment Fund  
September 23, 2015  
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**INDEPENDENT AUDITOR'S REPORT (CONTINUED)**

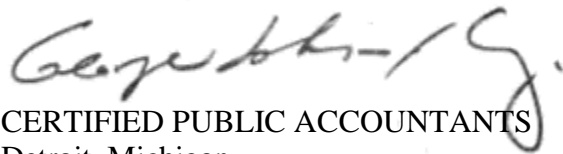
**Auditor's Responsibility (continued)**

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 Michigan Health Endowment Fund as of December 31, 2014, 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.



CERTIFIED PUBLIC ACCOUNTANTS  
Detroit, Michigan

MICHIGAN HEALTH ENDOWMENT FUND  
(A Michigan Non-Profit Corporation)

**STATEMENT OF FINANCIAL POSITION**

December 31, 2014

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**ASSETS**

**Current Assets:**

Cash and cash equivalents (Note C)	\$ 55,582,874
Other current assets	<u>351,605</u>

**Total Current Assets** **55,934,479**

**Other Assets:**

Investments (Note C)	<u>35,984,007</u>
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**Total Assets** **\$ 91,918,486**

**LIABILITIES AND NET ASSETS**

**Current Liabilities:**

Accounts payable and accrued liabilities	\$ 120,012
Grants payable - current portion (Note D)	<u>18,600,000</u>

**Total Current Liabilities** **18,720,012**

**Long-Term Liabilities:**

Grants payable (net of current portion) (Note D)	<u>11,998,650</u>
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**Total Liabilities** **30,718,662**

**Net Assets:**

Unrestricted	13,621,237
Temporarily restricted (Note E)	27,578,587
Permanently restricted (Note E)	<u>20,000,000</u>

**Total Net Assets** **61,199,824**

**Total Liabilities and Net Assets** **\$ 91,918,486**

See notes to financial statements.

MICHIGAN HEALTH ENDOWMENT FUND  
(A Michigan Non-Profit Corporation)

**STATEMENT OF ACTIVITIES**

**For the Year Ended December 31, 2014**

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**Changes in Unrestricted Net Assets:**

**Revenue:**

Contributions (Note E)	\$ 52,500,000
Net investment income (Note C)	<u>68,862</u>

**Total Unrestricted Revenue** **52,568,862**

**Expenses:**

Program services:	
Grants authorized	37,698,650
Administrative expenses:	
Contractual services	1,195,491
Other expenses	<u>53,484</u>

**Total Expenses** **38,947,625**

**Net Increase in Unrestricted Net Assets** **13,621,237**

**Changes in Temporarily Restricted Net Assets:**

Contributions (Note E)	27,500,000
Net investment income (Note C)	<u>78,587</u>

**Net Increase in Temporarily Restricted Net Assets** **27,578,587**

**Changes in Permanently Restricted Net Assets:**

Contributions (Note E)	<u>20,000,000</u>
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**Net Increase in Permanently Restricted Net Assets** **20,000,000**

**Net Increase in Net Assets** **61,199,824**

Net Assets, Beginning of Year -0-

**Net Assets, End of Year** **\$ 61,199,824**

See notes to financial statements.

MICHIGAN HEALTH ENDOWMENT FUND  
(A Michigan Non-Profit Corporation)

**STATEMENT OF CASH FLOWS**

**For the Year Ended December 31, 2014**

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**Cash Flows from Operating Activities:**

Cash received from contributions	\$ 100,000,000
Interest and dividends received	26,564
Cash paid for administrative expenses	(1,141,144)
Cash paid for grants	<u>(7,100,000)</u>

**Net Cash Provided by Operating Activities** **91,785,420**

**Cash Flows from Investing Activities:**

Purchases of investments	(205,571,384)
Sales and redemptions of investments	<u>169,368,838</u>

**Net Cash Provided (Used) by Investing Activities** **(36,202,546)**

**Net Increase in Cash and Cash Equivalents** **55,582,874**

Cash and Cash Equivalents Balance, Beginning of Year -0-

**Cash and Cash Equivalents Balance, End of Year** **\$ 55,582,874**

**Reconciliation of Net Increase in Net Assets to**

**Cash Flows from Operating Activities:**

Net increase in net assets	\$ 61,199,824
Adjustments to reconcile net increase in net assets to net cash provided by operating activities:	
Net realized and unrealized loss on investments	218,539
(Increase) decrease in other current assets	(351,605)
Increase in accounts payable and accrued liabilities	120,012
Increase in grants payable	<u>30,598,650</u>

**Net Cash Provided by Operating Activities** **\$ 91,785,420**

See notes to financial statements.

**NOTES TO FINANCIAL STATEMENTS**

**December 31, 2014**

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**NOTE A - NATURE OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Nature of Organization**

Michigan Health Endowment Fund (the “Fund”) was established in January 2014 as a Michigan non-profit Corporation. The Fund’s purpose is to support efforts that improve the quality of health care while reducing costs to residents of the State of Michigan, with a specific focus on those efforts that benefit the health and wellness of minor children and seniors in specific areas. The Fund was established in accordance with State of Michigan Public Act 4 of 2013 (the “Act”).

**Basis of Accounting**

The financial statements have been prepared on the accrual basis of accounting, which includes recognition of revenue when earned and expenses when incurred.

**Basis of Presentation**

The Fund reports information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

**Recognition of Contributions**

Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support, depending on the existence and/or nature of any donor restrictions. Unconditional contributions are recorded as support at the time verifiable evidence of the pledge is received. Conditional contributions are not recorded as support until the condition is met, at which time they become unconditional.

The Fund reports contributions of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires (that is, when a stipulated time restriction ends or a purpose restriction is accomplished), temporarily restricted net assets are reclassified to unrestricted net assets and are reported in the statement of activities as net assets released from restrictions.

**Investments**

The Fund’s investments are stated at fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price).



**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**

**December 31, 2014**

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**NOTE A - NATURE OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Investments (continued)**

Commercial paper, corporate bonds, and asset-backed securities which are not publicly traded on an open market are valued at quoted market prices if actively traded, or through a pricing model that utilizes benchmark yields, reported trades, active market quotes, and current spreads, among other factors.

Purchases and sales of investments are reflected on a trade-date basis. Net appreciation includes gains and losses on investments bought and sold, as well as held, during the year. Gains and losses on investments sold are generally determined on the specific identification method, with the amount realized reflecting the difference between fair value on the date of sale and original cost. Unrealized gains and losses represent the change in the fair value of investments during the year. Investment income is accrued as earned.

**Cash Equivalents**

For purposes of the statement of cash flows, the Fund considers all short-term, highly liquid securities purchased with original maturities of 30 days or less to be cash equivalents.

**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

**Fair Value Measurements**

The Fund uses fair value measurements in the preparation of its financial statements, which utilize various inputs, including those that can be readily observed, corroborated, or are generally unobservable. The Fund utilizes market-based data and valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Additionally, the Fund applies assumptions that market participants would use in pricing an asset or liability, including assumptions about risk.

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**

**December 31, 2014**

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**NOTE A - NATURE OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Fair Value Measurements (continued)**

The measurement of fair value includes a hierarchy based on the quality of inputs used to measure fair value. Financial assets and liabilities are categorized into this three-level fair value hierarchy, based on the inputs to the valuation technique. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets and liabilities and the lowest priority to unobservable inputs.

The various levels of the fair value hierarchy are described as follows:

- Level 1 - Financial assets and liabilities whose values are based on unadjusted quoted market prices for identical assets and liabilities in an active market that the Fund has the ability to access
- Level 2 - Financial assets and liabilities whose values are based on quoted prices in markets that are not active or model inputs that are observable for substantially the full term of the asset or liability
- Level 3 - Financial assets and liabilities whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement

The use of observable market data, when available, is required in making fair value measurements. When inputs used to measure fair value fall within different levels of the hierarchy, the level within which the fair value measurement is categorized is based on the lowest level input that is significant to the fair value measurement.

**Grants**

Grants, including unconditional promises to give, are recognized as expenses in the period the unconditional promises are made at their fair value. Unconditional promises to give over a future period of time are recorded at the present value of their estimated future cash flows using a discount rate that approximates the prime rate at the origination of the promise to give. As of December 31, 2014, the prime rate was 3.25 percent.

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**

**December 31, 2014**

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**NOTE A - NATURE OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Risks and Uncertainties**

The Fund invests in various securities, including commercial paper, corporate bonds, and asset-backed securities. Investments, in general, are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the value of investment securities that could materially affect the amounts reported in the financial statements will occur in the near term.

**Tax-Exempt Status**

The Fund is organized under section 501(c)(3) of the Internal Revenue Code (“IRC”) and has received a determination of its tax-exempt status from the Internal Revenue Service (“IRS”) as a publicly supported organization under IRC section 509(a)(2). The Fund’s management is not aware of any unrecognized tax benefits as of December 31, 2014. The Fund is subject to federal income tax examinations by the IRS for all years of its existence.

**Concentration of Credit Risk**

Financial instruments which potentially subject the Fund to concentrations of credit risk consist principally of cash, cash equivalents, and investments.

Cash and cash equivalents are maintained at financial institutions and, at times, balances may exceed the federally insured limit of \$250,000 per depositor at each financial institution. Cash and cash equivalents on deposit in excess of the federally insured limit as of December 31, 2014 approximated \$7.9 million. Investments are diversified among various commercial paper, corporate bonds, and asset-backed securities.

**Allocation of Expenses**

The Fund records grants issued as program service expenses. All other expenses, including certain costs that may support the Fund’s program services, are reported as administrative expenses in the accompanying statement of activities.

**Subsequent Events**

The Fund has evaluated subsequent events through September 23, 2015, the date that the accompanying financial statements were available to be issued. The Fund did not identify any subsequent events that would require recognition or disclosure in the financial statements.

MICHIGAN HEALTH ENDOWMENT FUND  
(A Michigan Non-Profit Corporation)

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**

**December 31, 2014**

**NOTE B - CONDITIONAL PROMISES TO RECEIVE**

Conditional promises to receive are recognized when the conditions on which they depend are substantially met. As of December 31, 2014, the Fund has a conditional promise to receive of \$1.46 billion from Blue Cross Blue Shield of Michigan (“BCBSM”), as required by the Act.

Under the agreement between the Fund and BCBSM, the payment plan is an annual cap amount scheduled to be paid on or before April 1 of each year, from 2014 through 2031, or the date when total contributions made by BCBSM to the Fund reaches \$1.56 billion. Payments vary by year, and may be accelerated or delayed upon the occurrence of various conditions. Two primary conditions relate to BCBSM achieving specified risk-based capital levels, as well as any other adjustments or relief which the Michigan Department of Insurance and Financial Services may grant.

**NOTE C - INVESTMENTS AND FAIR VALUE**

The Fund’s fair value hierarchy for those assets measured at fair value on a recurring basis as of December 31, 2014 is summarized as follows:

	<u>Fair Value Measurements</u>			<u>Total</u>
	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>	
<b>Assets:</b>				
Investments at fair value:				
Commercial paper	\$ -0-	\$ 4,993,200	\$ -0-	\$ 4,993,200
Corporate bonds		27,010,291		27,010,291
Asset-backed securities		3,980,516		3,980,516
<b>Total Investments</b>	<b>-0-</b>	<b>35,984,007</b>	<b>-0-</b>	<b>35,984,007</b>
Cash and cash equivalents:				
Money market funds	47,447,454			47,447,454
Cash	8,135,420			8,135,420
<b>Total Cash and Cash Equivalents</b>	<b>55,582,874</b>	<b>-0-</b>	<b>-0-</b>	<b>55,582,874</b>
	<b>\$ 55,582,874</b>	<b>\$ 35,984,007</b>	<b>\$ -0-</b>	<b>\$ 91,566,881</b>

MICHIGAN HEALTH ENDOWMENT FUND  
(A Michigan Non-Profit Corporation)

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**

**December 31, 2014**

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**NOTE C - INVESTMENTS AND FAIR VALUE (CONTINUED)**

For the year ended December 31, 2014, the Fund's net investment income is summarized as follows:

Net realized and unrealized gain (loss)	\$ (218,539)
Interest income	<u>365,988</u>
<b>Net Investment Income</b>	<b><u><u>\$ 147,449</u></u></b>

Net investment income is reflected on the Fund's statements of activities for the year ended December 31, 2014 as follows:

Unrestricted	\$ 68,862
Temporarily restricted	<u>78,587</u>
	<b><u><u>\$ 147,449</u></u></b>

**NOTE D - GRANTS PAYABLE**

The Fund's Board of Directors has approved grants payable as of December 31, 2014, for which all conditions have been met and which are scheduled to be paid as follows:

Amounts due in:	
Less than one year	\$ 18,600,000
One to five years	<u>12,450,000</u>
	31,050,000
Less: Discount (at 3.25 percent)	<u>(451,350)</u>
	<b><u><u>\$ 30,598,650</u></u></b>

**NOTE E - ENDOWMENT FUND**

The Fund was the recipient of a \$100 million contribution from BCBSM during the year ended December 31, 2014. It represents the first payment of a total commitment of \$1.56 billion over 18 years (see Note B).

MICHIGAN HEALTH ENDOWMENT FUND  
(A Michigan Non-Profit Corporation)

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**

**December 31, 2014**

**NOTE E - ENDOWMENT FUND (CONTINUED)**

The Fund may expend a portion of the contributions in each year for operations and in fulfillment of its mission, and is required to maintain the remaining portion of each year's contribution in an endowment fund, according to the following schedule:

<u>Years</u>	<u>Available for Expenditure</u>	<u>Required for Endowment Fund</u>
2014-2017	80 %	20 %
2018-2021	67	33
2022-2025	60	40
2026-2031	25	75

The Fund's Board of Directors has interpreted existing law as requiring the preservation of the fair value of the deposits contributed to the endowment fund. As a result of this interpretation, the Fund classifies in permanently restricted net assets the portion of the annual contributions that is required to be maintained in the endowment fund, based on the schedule above. Although the income generated by the endowment fund may be used to support various activities of the Fund, the remaining portion of the endowment fund that is not classified in permanently restricted net assets, including voluntary additional deposits authorized by the Fund's Board of Directors, is subject to a time restriction and, therefore, is classified in temporarily restricted net assets. Once the accumulated principal held in the endowment fund reaches \$750 million, that balance will be required to be maintained in perpetuity to provide ongoing income to the Fund.

The Fund may invest in only securities that Michigan law permits for life insurance companies. The Fund's current policy is to allocate investments between fixed income securities and cash equivalents in a manner to avoid undue risk concentration in any single asset class or investment category. The general policy is also to diversify investments between industries to prevent overexposure to any one part of the economy. The asset allocation is monitored on an ongoing basis, reviewed, and rebalanced, if necessary, at least annually.

The endowment fund balance is reflected in the accompanying financial statements as of December 31, 2014 as follows:

Temporarily restricted	\$ 27,578,587
Permanently restricted	<u>20,000,000</u>
	<b><u>\$ 47,578,587</u></b>

MICHIGAN HEALTH ENDOWMENT FUND  
(A Michigan Non-Profit Corporation)

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**

**December 31, 2014**

**NOTE E - ENDOWMENT FUND (CONTINUED)**

Reconciliations of the fair value of endowment fund assets included in the Fund's financial statements are as follows for the year ended December 31, 2014:

	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
<b>Changes in Endowment Fund Assets:</b>			
Net investment income	\$ 78,587	\$ -0-	\$ 78,587
Contributions	<u>27,500,000</u>	<u>20,000,000</u>	<u>47,500,000</u>
<b>Net Increase in Endowment Fund Assets</b>	<b>27,578,587</b>	<b>20,000,000</b>	<b>47,578,587</b>
Endowment Fund Assets, Beginning of Year	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>
<b>Endowment Fund Assets, End of Year</b>	<b><u>\$ 27,578,587</u></b>	<b><u>\$ 20,000,000</u></b>	<b><u>\$ 47,578,587</u></b>

**NOTE F - NEW ACCOUNTING PRONOUNCEMENTS**

The Financial Accounting Standards Board issued Accounting Standards Update (“ASU”) 2015-07, *Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*, in May 2015. ASU 2015-07 removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient, and also removes the requirement to make certain disclosures for those investments that are eligible to be measured at fair value using the net asset value per share practical expedient but for which the entity has not elected to measure the fair value using that practical expedient. ASU 2015-07 applies to the Fund's financial statements for the year ending December 31, 2017, with earlier implementation permitted, and is to be applied retrospectively. The Fund's management has not determined the impact on its financial statements as a result of implementing ASU 2015-07.