



Kansas Health Foundation



Financial Statements

Years ended December 31, 2008 and 2007

(with report of independent certified public accountants thereon)



Grant Thornton

Report of Independent Certified Public Accountants

Board of Directors
Kansas Health Foundation

We have audited the accompanying balance sheets of Kansas Health Foundation as of December 31, 2008 and 2007, and the related statements of activity and cash flows for the years then ended. These financial statements are the responsibility of the Foundation's management. 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 as established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing 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 over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Kansas Health Foundation as of December 31, 2008 and 2007, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Grant Thornton LLP

Wichita, Kansas
July 6, 2009

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KANSAS HEALTH FOUNDATION
Balance Sheets
December 31, 2008 and 2007

	2008	2007
Assets		
Cash and cash equivalents	\$ 23,525,085	7,277,549
Investments (Note 3)	349,886,021	528,100,516
Accrued interest and dividends receivable	269,581	417,352
Due from brokers	11,792	241,458
Excise taxes receivable (Note 8)	291,630	206,445
Property and equipment, net (Note 4)	3,957,549	4,004,176
Other assets	<u>554,231</u>	<u>932,908</u>
	<u>\$ 378,495,889</u>	<u>541,180,404</u>
 Liabilities and Net Assets		
Due to brokers	\$ 15,296	618,630
Accounts payable	130,694	89,617
Grants payable (Note 7)	19,711,065	22,467,794
Accrued expenses	321,008	753,329
Deferred excise taxes payable (Note 8)	—	2,213,467
Commitments (Note 3)	<u>—</u>	<u>—</u>
Total liabilities	<u>20,178,063</u>	<u>26,142,837</u>
Net assets	<u>358,317,826</u>	<u>515,037,567</u>
	<u>\$ 378,495,889</u>	<u>541,180,404</u>

See accompanying notes to financial statements.

KANSAS HEALTH FOUNDATION
Statements of Activity
Years Ended December 31, 2008 and 2007

	2008	2007
Revenues and gains (losses):		
Investment income (Note 3)	\$ 8,183,077	16,063,251
Net realized and unrealized gains (losses) on investments (Note 3)	(144,197,911)	26,335,548
Investment expenses	(1,554,898)	(1,611,785)
Other income (Note 9)	<u>654,221</u>	<u>352,080</u>
Total revenues and gains (losses)	<u>(136,915,511)</u>	<u>41,139,094</u>
Program grants, net (Note 7)	<u>17,439,558</u>	<u>19,251,802</u>
Operating expenses (Note 6):		
Compensation and benefits	2,428,169	3,095,161
Professional and contractual services	829,516	632,280
Depreciation	260,027	269,716
Other	<u>697,044</u>	<u>692,250</u>
Total operating expenses	<u>4,214,756</u>	<u>4,689,407</u>
(Decrease) increase in net assets before excise taxes	(158,569,825)	17,197,885
Excise (taxes) benefit (Note 8)	<u>1,850,084</u>	<u>(451,458)</u>
(Decrease) increase in net assets	(156,719,741)	16,746,427
Net assets, beginning of year	<u>515,037,567</u>	<u>498,291,140</u>
Net assets, end of year	<u>\$ 358,317,826</u>	<u>515,037,567</u>

See accompanying notes to financial statements.

KANSAS HEALTH FOUNDATION
Statements of Cash Flows
Years Ended December 31, 2008 and 2007

	2008	2007
Cash flows from operating activities:		
(Decrease) increase in net assets	\$ (156,719,741)	16,746,427
Adjustments to reconcile (decrease) increase in net assets to net cash used in operating activities:		
Net realized and unrealized (gains) losses		
on investments	144,197,911	(26,335,548)
Depreciation	260,027	269,716
Net loss on disposition of equipment	10,488	309
Changes in assets and liabilities:		
Accrued interest and dividends receivable	147,771	115,595
Excise taxes receivable	(85,185)	114,658
Other assets	378,677	(114,034)
Accounts payable	41,077	23,817
Grants payable	(2,756,729)	(4,089,173)
Accrued expenses	(432,321)	439,467
Deferred excise taxes	(2,213,467)	(63,200)
	<u>(17,171,492)</u>	<u>(12,891,966)</u>
Net cash used in operating activities		
	<u>(17,171,492)</u>	<u>(12,891,966)</u>
Cash flows from investing activities:		
Additions to property and equipment	(269,173)	(249,174)
Proceeds from sale of equipment	45,285	575
Proceeds from sale of investments	126,572,141	96,216,961
Purchase of investments	(92,555,557)	(83,554,919)
Decrease (increase) in due from brokers	229,666	(164,685)
(Decrease) increase in due to brokers	(603,334)	353,897
	<u>33,419,028</u>	<u>12,602,655</u>
Net cash provided by investing activities		
	<u>33,419,028</u>	<u>12,602,655</u>
Net increase (decrease) in cash and cash equivalents		
	16,247,536	(289,311)
Cash and cash equivalents, beginning of year	<u>7,277,549</u>	<u>7,566,860</u>
Cash and cash equivalents, end of year	<u>\$ 23,525,085</u>	<u>7,277,549</u>

See accompanying notes to financial statements.

KANSAS HEALTH FOUNDATION
Notes to Financial Statements
December 31, 2008 and 2007

(1) Organization and Operations

The Kansas Health Foundation (Foundation) is a private philanthropy dedicated to improving the health of all Kansans. The Foundation qualifies as an organization exempt from federal income tax pursuant to Internal Revenue Code (Code) Section 501(c)(3) and as a private foundation within the meaning of Code Section 509(a) under a determination letter received from the Internal Revenue Service dated December 29, 1993.

(2) Summary of Significant Accounting Policies

Basis of Accounting

The accompanying financial statements are prepared on the accrual basis of accounting. Revenue is recognized when earned and expenses are recognized upon receipt of goods or services.

Investments

Investments are recorded at fair value in the accompanying financial statements. The Foundation has adopted Statement of Financial Accounting Standards 157, *Fair Value Measurements (FAS 157)*, effective January 1, 2008. FAS 157 creates a single definition of fair value, establishes a framework for measuring fair value, and expands disclosure requirements about assets and liabilities measured at fair value. FAS 157 requires fair value to be determined 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 (that is, an exit price).

As described further in note 3, under FAS 157 fair value for level 1 assets is generally determined based on quoted market prices in active markets for identical assets and liabilities. Where quoted market prices are not available, the Foundation uses valuation techniques that place greater reliance on observable inputs and less reliance on unobservable inputs in determining fair value. For level 3 assets which are comprised of commingled funds and trusts, and limited partnerships (funds), these investments are valued by the Foundation at net asset value as provided by the fund's administrator or general partner. Where available, the Foundation uses net asset value from the funds' audited financial statements to record fair value.

In general, the Foundation's investments are exposed to various risks, such as interest rate, credit and overall market volatility risk. Due to these risks, it is possible that changes in the values of investments could occur in the near term and that such changes could materially affect the net assets recorded in the accompanying financial statements.

Cash Equivalents

Cash equivalents represent short-term investments with original maturities of three months or less. A majority of cash equivalents are invested in an institutional, interest bearing money market fund.

KANSAS HEALTH FOUNDATION
Notes to Financial Statements
December 31, 2008 and 2007

(2) Summary of Significant Accounting Policies, continued

Property and Equipment

Property and equipment are recorded at cost. Depreciation is being provided on depreciable assets over the estimated useful lives of the respective assets on the straight-line basis.

Program Grants

Program grants are recorded in the accompanying financial statements when the Foundation has an obligation to transfer assets to a grantee, normally when a grant contract is executed. Grants are recorded based on the present value of estimated future cash flows, discounted at an average annual market rate of interest in the year of approval.

Use of Estimates

Foundation management has made estimates and assumptions relating to the reporting of assets and liabilities, and the disclosure of contingent assets and liabilities, in preparing these financial statements in conformity with accounting principles generally accepted in the United States of America. Estimates also affect the reported amounts of revenues, gains, program grants and operating expenses during the reporting period. Actual results could differ from these estimates.

Fair Value of Financial Instruments

Statement of Financial Accounting Standards No. 107, "Disclosure About Fair Value of Financial Instruments", requires that the Foundation disclose estimated fair values for its financial instruments. The carrying values of the Foundation's financial instruments approximate their fair value.

(3) Investments

Investment Objective

The Foundation's long-term financial objectives are to preserve and enhance the inflation adjusted value of its assets in perpetuity and provide a relatively stable stream of earnings consistent with spending needs. These financial objectives are intended to balance the needs of current and future generations of the Foundation's beneficiaries. The primary long-term investment objective of the Foundation is to earn an average annual inflation adjusted total return of at least 5%, net of all investment management fees, operating expenses and taxes over long-term periods.

KANSAS HEALTH FOUNDATION
Notes to Financial Statements
December 31, 2008 and 2007

(3) Investments, continued

Composition of Investments

Investments presented in the accompanying financial statements are composed of the following:

	December 31, 2008	
	<u>Cost</u>	<u>Fair Value</u>
Equity securities and commingled funds	\$ 216,783,153	169,336,086
Marketable alternative equities	47,262,152	50,565,340
Real estate investment trusts	20,857,598	14,576,840
Non-marketable investments	29,882,427	25,361,559
Fixed income commingled funds	76,545,939	77,726,293
U.S. Treasury obligations	11,851,777	12,319,903
	<u>\$ 403,183,046</u>	<u>349,886,021</u>
	December 31, 2007	
	<u>Cost</u>	<u>Fair Value</u>
Equity securities and commingled funds	\$ 196,156,808	280,101,452
Marketable alternative equities	54,494,887	74,503,588
Real estate investment trusts	19,285,668	23,275,965
Non-marketable investments	19,698,617	20,125,433
Fixed income commingled funds	100,957,377	100,930,624
U.S. Treasury obligations	26,988,048	29,163,454
	<u>\$ 417,581,405</u>	<u>528,100,516</u>

Components of Investment Return

The components of investment return in the statements of activity are as follows:

	2008	2007
Interest and dividends	\$ 8,183,077	16,063,251
Realized gains and losses	19,618,225	29,649,765
Unrealized gains and losses	<u>(163,816,136)</u>	<u>(3,314,217)</u>
	<u>\$ (136,014,834)</u>	<u>42,398,799</u>

KANSAS HEALTH FOUNDATION
Notes to Financial Statements
December 31, 2008 and 2007

(3) Investments, continued

Fair value measurements

As disclosed in note 2, the Foundation adopted FAS 157 effective January 1, 2008. FAS 157 establishes a fair value hierarchy that distinguishes between assumptions based on market data (observable inputs) and Foundation assumptions (unobservable inputs). The determination of where an asset or liability falls in the hierarchy requires significant judgment. The hierarchy consists of three broad levels as follows:

Level 1 – Quoted market prices in active markets for identical assets or liabilities

Level 2 – Inputs other than level 1 inputs that are either directly or indirectly observable, including inputs in markets that are not considered to be active

Level 3 – Inputs that are unobservable

Fair value of the Foundation's investments at December 31, 2008 has been determined using the valuation hierarchy as follows:

Assets	Level 1	Level 2	Level 3
Equity securities and commingled funds	\$ 78,492,067	–	90,844,019
Marketable alternative equities	–	–	50,565,340
Real estate investment trusts	–	–	14,576,840
Non-marketable investments	–	–	25,361,559
Fixed income commingled funds	33,255,300	–	44,470,993
U.S. Treasury obligations	12,319,903	–	–
	<u>\$ 124,067,270</u>	<u>–</u>	<u>225,818,751</u>

The following table presents additional information about investments measured at fair value using significant unobservable inputs (level 3):

Investments	Equity securities and commingled funds	Marketable alternative equities	Real estate investment trusts	Non-marketable investments	Fixed income commingled funds	Total
Balance - January 1, 2008	\$ 152,088,403	74,503,588	23,275,965	20,125,433	53,521,706	323,515,095
Total realized and unrealized gains (losses)	(63,867,166)	(12,529,472)	(10,464,065)	(5,258,884)	3,256,184	(88,863,403)
Net purchases (sales)	2,622,782	(11,408,776)	1,764,940	10,495,010	(12,306,897)	(8,832,941)
Balance - December 31, 2008	<u>\$ 90,844,019</u>	<u>50,565,340</u>	<u>14,576,840</u>	<u>25,361,559</u>	<u>44,470,993</u>	<u>225,818,751</u>

KANSAS HEALTH FOUNDATION
Notes to Financial Statements
December 31, 2008 and 2007

(3) Investments, continued

As of December 31, 2008 the Foundation had made commitments totaling approximately \$45,714,000 under investment management agreements to fund certain real estate, natural resources and other non-marketable investments as managers request the funds. Management anticipates these commitments will be funded over the next four to five years.

Subsequent to December 31, 2008 the Foundation's liquidity in one commingled fixed income trust, with a fair value of \$44,470,993 as of December 31, 2008, was substantially restricted by the trustee due to concerns regarding the possible forced liquidation of underlying collateral in its securities lending program. Currently, the Foundation may only withdraw 4% of its funds from the trust monthly. The 4% is cumulative to future months if not withdrawn monthly. The Foundation has not incurred any losses due to this restriction and has sufficient liquidity from other investments.

(4) Property and Equipment

A summary of property and equipment follows:

	2008	2007
Land	\$ 953,428	953,428
Building and Improvements	4,157,700	4,038,147
Equipment, furniture and fixtures	<u>1,747,170</u>	<u>1,705,309</u>
	6,858,298	6,696,884
Less accumulated depreciation	<u>(2,900,749)</u>	<u>(2,692,708)</u>
Property and equipment, net	<u><u>\$ 3,957,549</u></u>	<u><u>4,004,176</u></u>

Depreciation is provided on the straight-line basis over the following useful lives:

Building and improvements	3-40 years
Equipment, furniture and fixtures	3-10 years

(5) Employees' Retirement Plans

The Foundation provides retirement benefits to its employees through two defined contribution pension plans. All employees are eligible to participate in the plans immediately on employment. The Foundation contributed \$223,665 and \$253,208 to the plans in 2008 and 2007, respectively. The Foundation's policy is to fund pension costs as accrued and no prior service costs exist under the plans. Employees may contribute additional amounts to the plans. Employer and employee contributions are fully vested when the employee becomes eligible for participation.

KANSAS HEALTH FOUNDATION
Notes to Financial Statements
December 31, 2008 and 2007

(6) Functional Classification of Operating Expenses

The Foundation's operating expenses for 2008 and 2007 are allocated among the following functions on the basis of staff time incurred and office space utilization:

	2008	2007
Program activities	\$ 3,352,243	3,753,406
Investment activities	674,085	803,647
Management and general	<u>188,428</u>	<u>132,354</u>
	<u>\$ 4,214,756</u>	<u>4,689,407</u>

(7) Grants Payable and Program Grants

As discussed in note 2, program grants are recorded on a discounted present value basis. At December 31, 2008 and 2007, the grant contracts and discount were as follows:

	2008	2007
Grant contracts	\$ 32,649,593	29,449,903
Discount	<u>(12,938,528)</u>	<u>(6,982,109)</u>
Grants payable	<u>\$ 19,711,065</u>	<u>22,467,794</u>

In addition to grants payable recorded in the financial statements, the Foundation's Board of Directors has authorized funding for future grants for certain of its program areas. Authorized grants are not recorded as grants payable and program grants in the financial statements since grant contracts have not been executed. Management's best estimate of when the total of grant contracts and authorized grants as of December 31, 2008 will be paid is as follows:

	Grant Contracts	Authorized Grants
2009	\$ 3,739,410	\$ 2,973,263
2010	5,428,616	3,504,877
2011	3,698,697	4,169,252
2012	3,480,276	3,585,272
2013	3,254,062	7,790,241
2014-2020	<u>13,048,532</u>	<u>42,169,261</u>
	<u>\$ 32,649,593</u>	<u>\$ 64,192,166</u>

**KANSAS HEALTH FOUNDATION
Notes to Financial Statements
December 31, 2008 and 2007**

(7) Grants Payable and Program Grants, continued

Included in December 31, 2008 grant contracts is \$21 million, estimated to be payable at about \$3 million per year from 2011 through 2017 for core operations of the Kansas Health Institute (KHI), a non-profit, tax exempt corporation located in Topeka, Kansas. KHI was created by the Foundation in 1994 as a health policy and research institute for Kansas.

Included in December 31, 2008 grant contracts and authorized grants is \$2 million and \$23.3 million, respectively, estimated to be payable at about \$2 million per year through 2020, for core operations of a separate non-profit, tax exempt corporation, the Kansas Leadership Center (KLC). KLC was created by the Foundation in 2006 and began operations in Wichita, Kansas in 2007. KLC's mission is to cultivate civic leadership across Kansas. The Foundation has made core grant payments of \$450,000 in 2008 and \$4,050,000 in 2007 to KLC.

Program grants in the statements of activity are reported net of grant amounts refunded and grant contracts written off.

(8) Excise and Income Taxes

The Foundation is exempt from Federal income taxes under Section 501(a) of the Internal Revenue Code of 1986, as amended, as an organization described in Section 501(c)(3). Accordingly, the Foundation is not subject to Federal income tax, except to the extent that it has unrelated business taxable income. In the opinion of management, the Foundation did not have material unrelated business taxable income in 2008. As of December 31, 2007, the Foundation had a cumulative net operating loss carryforward of \$64,853 which is available to offset future taxable income. No provision for Federal income taxes is recorded in the accompanying financial statements.

The Foundation is classified as a private foundation under Section 509(a) and, as such, is subject to a Federal excise tax of 2% on net investment income, unless certain conditions are met, in which case the Federal excise tax is reduced to 1%. In 2008 and 2007, the Foundation was subject to an excise tax on net investment income of 1%. Taxes receivable in the accompanying balance sheets represent refunds due on federal excise taxes paid in excess of the related excise tax expense as of December 31, 2008 and 2007 respectively. The Foundation made estimated excise tax payments of \$450,000 in 2008 and \$400,000 in 2007.

Deferred excise taxes are provided for on the unrealized increase in the fair value of the Foundation's investment assets at a 2% rate as of December 31, 2007. As of December 31, 2008 the cost of the Foundation's portfolio exceeded its fair value and as a result no deferred taxes are provided. Excise tax expense consists of the following:

	2008	2007
Current excise tax expense	\$ (363,383)	(514,658)
Deferred excise tax benefit	<u>2,213,467</u>	<u>63,200</u>
Total excise (tax) benefit	<u>\$ 1,850,084</u>	<u>(451,458)</u>

KANSAS HEALTH FOUNDATION
Notes to Financial Statements
December 31, 2008 and 2007

(8) Excise and Income Taxes, continued

The Foundation is also required to make certain minimum qualifying distributions of its assets for charitable purposes in accordance with formulas provided by Federal law. The Foundation has complied with such requirements.

(9) Land Lease

The Foundation, as lessor, has leased certain land (cost-\$366,155) under a long-term operating lease which expires in 2081. Future rentals to be received under the lease are as follows:

2009	\$	107,140
2010		107,140
2011		107,140
2012		107,140
2013		107,140
2014-2081		<u>7,286,176</u>
	\$	<u><u>7,821,876</u></u>