

**American Academy of Family Physicians
Foundation and Subsidiary**

Independent Auditor's Report and Consolidated Financial Statements

December 31, 2016 and 2015



**American Academy of Family Physicians
Foundation and Subsidiary
December 31, 2016 and 2015**

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Independent Auditor's Report

Board of Trustees
American Academy of Family Physicians
Foundation and Subsidiary
Leawood, Kansas

We have audited the accompanying consolidated financial statements of American Academy of Family Physicians Foundation and Subsidiary, which comprise the consolidated statement of financial position as of December 31, 2016, and the related consolidated statements of activities and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated 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 consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of American Academy of Family Physicians Foundation and Subsidiary as of December 31, 2016, and the changes in their net assets and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Summarized Consolidated Comparative Information

We have previously audited the December 31, 2015 consolidated financial statements, and we expressed an unmodified audit opinion on those audited consolidated financial statements in our report dated May 25, 2016. In our opinion, the summarized consolidated comparative information presented herein as of and for the year ended December 31, 2015 is consistent, in all material respects, with the consolidated audited financial statements from which it has been derived.

Other Matter

Our audit was conducted for the purpose of forming an opinion on the basic consolidated financial statements as a whole. The consolidating information is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

BKD, LLP

Kansas City, Missouri
May 21, 2017

**American Academy of Family Physicians
Foundation and Subsidiary
Consolidated Statement of Financial Position
December 31, 2016
(with Comparative Totals for 2015)**

Assets	2016			Consolidated Total	Comparative Totals for 2015
	Foundation	Insurance Services	Eliminations		
Cash and cash equivalents	\$ 506,987	\$ 968,111	\$ -	\$ 1,475,098	\$ 2,277,740
Cash and cash equivalents - premium account	-	3,212,854	-	3,212,854	3,205,120
Accounts receivable	215,466	677,964	-	893,430	766,051
Prepaid expenses	41,222	50,710	-	91,932	162,609
Investments at fair value	15,245,323	-	-	15,245,323	14,799,477
Investment in subsidiary	1,601,100	-	(1,601,100)	-	-
Contributions receivable	30,000	-	-	30,000	-
Beneficial interest in trust assets	54,593	-	-	54,593	53,536
Deferred tax asset	-	34,900	-	34,900	35,900
Office equipment, furniture and fixtures, net of accumulated depreciation; 2016 - \$790,978, 2015 - \$775,393	81,648	33,056	-	114,704	31,665
	<u>\$ 17,776,339</u>	<u>\$ 4,977,595</u>	<u>\$ (1,601,100)</u>	<u>\$ 21,152,834</u>	<u>\$ 21,332,098</u>
Liabilities and Net Assets					
Liabilities					
Accounts payable and accrued expenses	\$ 794,638	\$ 132,273	\$ -	\$ 926,911	\$ 1,018,693
Premiums payable	-	3,213,087	-	3,213,087	3,204,898
Grant awards payable	319,436	-	-	319,436	428,624
Deferred revenue and advances	105,206	-	-	105,206	201,438
Liabilities under split-interest agreements	197,847	-	-	197,847	64,638
Deferred tax liability	-	12,000	-	12,000	11,400
Federal and state income taxes payable	-	19,135	-	19,135	13,228
Total liabilities	<u>1,417,127</u>	<u>3,376,495</u>	<u>-</u>	<u>4,793,622</u>	<u>4,942,919</u>
Net Assets					
Unrestricted					
Undesignated	2,821,016	1,601,100	(1,601,100)	2,821,016	2,819,682
Board designated	10,060,303	-	-	10,060,303	10,326,750
Total unrestricted	<u>12,881,319</u>	<u>1,601,100</u>	<u>(1,601,100)</u>	<u>12,881,319</u>	<u>13,146,432</u>
Temporarily restricted	1,590,480	-	-	1,590,480	1,470,761
Permanently restricted	1,887,413	-	-	1,887,413	1,771,986
Total net assets	<u>16,359,212</u>	<u>1,601,100</u>	<u>(1,601,100)</u>	<u>16,359,212</u>	<u>16,389,179</u>
Total liabilities and net assets	<u>\$ 17,776,339</u>	<u>\$ 4,977,595</u>	<u>\$ (1,601,100)</u>	<u>\$ 21,152,834</u>	<u>\$ 21,332,098</u>

**American Academy of Family Physicians
Foundation and Subsidiary
Consolidated Statement of Activities
Year Ended December 31, 2016
(with Comparative Totals for 2015)**

	2016			Consolidated Total	Comparative Totals for 2015
	Foundation	Insurance Services	Eliminations		
Unrestricted Net Assets					
Revenues, Gains and Other Support					
Grant revenue	\$ 56,480	\$ -	\$ -	\$ 56,480	\$ 15,464
Corporate and chapter support	876,667	-	-	876,667	875,000
Individual contributions	505,764	-	-	505,764	478,176
Special events, net of direct expenses of \$39,268 in 2016 and \$28,983 in 2015	53,527	-	-	53,527	43,838
Investment return	695,610	-	-	695,610	9,268
Insurance agreement revenues	-	3,922,265	-	3,922,265	4,014,834
Net assets released from restrictions	905,663	-	-	905,663	1,544,723
Total revenues, gains and other support	<u>3,093,711</u>	<u>3,922,265</u>	<u>-</u>	<u>7,015,976</u>	<u>6,981,303</u>
Expenses and Losses					
Insurance services	-	2,821,965	-	2,821,965	2,951,985
Board, general, staff and administration	487,159	-	-	487,159	457,966
Family Medicine Philanthropic Consortium	91,048	-	-	91,048	89,192
Center for the History of Family Medicine	254,609	-	-	254,609	243,938
Family Medicine Cares	334,354	-	-	334,354	221,482
Family Medicine Leads	388,684	-	-	388,684	326,199
Grant awards and administration	432,667	-	-	432,667	707,390
Individual development	759,204	-	-	759,204	679,248
Professional and corporate affairs	183,510	-	-	183,510	179,147
Peers for Progress	-	-	-	-	751,588
Programs, other	1,527,889	-	-	1,527,889	1,406,654
Total expenses and losses	<u>4,459,124</u>	<u>2,821,965</u>	<u>-</u>	<u>7,281,089</u>	<u>8,014,789</u>
Change in unrestricted net assets	<u>(1,365,413)</u>	<u>1,100,300</u>	<u>-</u>	<u>(265,113)</u>	<u>(1,033,486)</u>
Temporarily Restricted Net Assets					
Grant revenues	652,777	-	-	652,777	1,306,832
Corporate and chapter support	5,000	-	-	5,000	5,000
Individual contributions	209,354	-	-	209,354	219,399
Special events	1,545	-	-	1,545	2,394
Investment return	156,706	-	-	156,706	(21,505)
Net assets released from restrictions	(905,663)	-	-	(905,663)	(1,544,723)
Change in temporarily restricted net assets	<u>119,719</u>	<u>-</u>	<u>-</u>	<u>119,719</u>	<u>(32,603)</u>
Permanently Restricted Net Assets					
Corporate and chapter support	36,000	-	-	36,000	36,000
Individual contributions	64,633	-	-	64,633	48,707
Investment return	14,794	-	-	14,794	17,623
Change in permanently restricted net assets	<u>115,427</u>	<u>-</u>	<u>-</u>	<u>115,427</u>	<u>102,330</u>
Increase (Decrease) in Net Assets Before					
Earnings of Subsidiary and Dividends Paid	(1,130,267)	1,100,300	-	(29,967)	(963,759)
Earnings of Subsidiary	1,100,300	-	(1,100,300)	-	-
Dividends Paid	-	(1,066,000)	1,066,000	-	-
Increase (Decrease) in Net Assets	(29,967)	34,300	(34,300)	(29,967)	(963,759)
Net Assets, Beginning of Year	16,389,179	1,566,800	(1,566,800)	16,389,179	17,352,938
Net Assets, End of Year	<u>\$ 16,359,212</u>	<u>\$ 1,601,100</u>	<u>\$ (1,601,100)</u>	<u>\$ 16,359,212</u>	<u>\$ 16,389,179</u>

**American Academy of Family Physicians
Foundation and Subsidiary
Consolidated Statement of Cash Flows
Year Ended December 31, 2016
(with Comparative Totals for 2015)**

	2016			Consolidated Total	Comparative Totals for 2015
	Foundation	Insurance Services	Eliminations		
Operating Activities					
Change in net assets	\$ (29,967)	\$ 1,100,300	\$ (1,100,300)	\$ (29,967)	\$ (963,759)
Items not requiring (providing) operating cash flows					
Depreciation	12,699	13,680	-	26,379	19,986
Net realized and unrealized losses (gains) on investments	(635,980)	-	-	(635,980)	312,672
Loss (gain) on split-interest agreements	(10,597)	-	-	(10,597)	4,753
Contributions of investment securities	(180,638)	-	-	(180,638)	(10,827)
Contributions and investment income received restricted for long-term investment	(101,554)	-	-	(101,554)	(87,828)
Change in investment in subsidiary	(34,300)	-	34,300	-	-
Deferred income taxes	-	1,600	-	1,600	(900)
Change in					
Accounts receivable	(85,586)	(41,793)	-	(127,379)	161,311
Prepaid expenses	35,701	(4,636)	-	31,065	(11,201)
Contributions receivable	(30,000)	-	-	(30,000)	-
Accounts payable and accrued expenses	(103,449)	11,667	-	(91,782)	(383,102)
Premiums payable	-	8,189	-	8,189	(167,198)
Grant awards payable	(109,188)	-	-	(109,188)	50,081
Deferred revenue and advances	(96,232)	-	-	(96,232)	(974,505)
Federal and state income taxes payable	-	5,907	-	5,907	6,544
Net cash provided by (used in) operating activities	<u>(1,369,091)</u>	<u>1,094,914</u>	<u>(1,066,000)</u>	<u>(1,340,177)</u>	<u>(2,043,973)</u>
Investing Activities					
Purchase of office equipment, furniture and fixtures	(94,210)	(15,208)	-	(109,418)	(5,470)
Purchase of investments	(6,245,960)	-	-	(6,245,960)	(7,913,621)
Sales and maturities of investments	6,626,272	-	-	6,626,272	8,088,117
Net cash provided by (used in) investing activities	<u>286,102</u>	<u>(15,208)</u>	<u>-</u>	<u>270,894</u>	<u>169,026</u>
Financing Activities					
Proceeds from contributions and investment income restricted for long-term investment	101,554	-	-	101,554	87,828
Proceeds from annuities	176,800	-	-	176,800	-
Payments on annuities	(3,979)	-	-	(3,979)	-
Cash dividends paid	-	(1,066,000)	1,066,000	-	-
Net cash provided by (used in) financing activities	<u>274,375</u>	<u>(1,066,000)</u>	<u>1,066,000</u>	<u>274,375</u>	<u>87,828</u>
Increase (Decrease) in Cash and Cash Equivalents	(808,614)	13,706	-	(794,908)	(1,787,119)
Cash and Cash Equivalents, Beginning of Year	1,315,601	4,167,259	-	5,482,860	7,269,979
Cash and Cash Equivalents, End of Year	<u>\$ 506,987</u>	<u>\$ 4,180,965</u>	<u>\$ -</u>	<u>\$ 4,687,952</u>	<u>\$ 5,482,860</u>
Reconciliation of Cash and Cash Equivalents to the Statement of Financial Position					
Cash and cash equivalents	\$ 506,987	\$ 968,111	\$ -	\$ 1,475,098	\$ 2,277,740
Cash and cash equivalents - premium account	-	3,212,854	-	3,212,854	3,205,120
	<u>\$ 506,987</u>	<u>\$ 4,180,965</u>	<u>\$ -</u>	<u>\$ 4,687,952</u>	<u>\$ 5,482,860</u>
Supplemental Cash Flows Information					
Income taxes paid	\$ -	\$ 683,493	\$ -	\$ 683,493	\$ 663,171

**American Academy of Family Physicians
Foundation and Subsidiary
Notes to Consolidated Financial Statements
December 31, 2016 and 2015**

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

The American Academy of Family Physicians Foundation (the Foundation) is a not-for-profit organization whose mission and principal activity is to serve as a fiscal intermediary for programs that serve to promote and benefit family medicine throughout the United States of America. The Foundation encourages philanthropy, awards research grants, offers education programs and maintains a center for the history of family medicine. The Foundation's donors and members are located primarily throughout the United States of America.

AAFP Insurance Services, Inc. (Insurance Services) is a wholly-owned, for-profit subsidiary of the Foundation. Insurance Services administers and sells various types of insurance plans (life, medical, disability, accidental death, etc.) to members of the American Academy of Family Physicians (the Academy), which is the sole contract holder of such plans. Insurance Services maintains a relationship with one insurance company that services a majority of these plans and through agreements provides the source for a significant portion of revenues from insurance plans.

Principles of Consolidation

The consolidated financial statements include the accounts of the Foundation and its wholly-owned subsidiary, Insurance Services (hereinafter collectively known as the Organization). All significant intercompany accounts and transactions have been eliminated in consolidation.

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 consolidated financial statements and the reported amounts of revenues, expenses, gains, losses and other changes in net assets during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Organization considers all liquid investments with original maturities of three months or less to be cash equivalents. At December 31, 2016 and 2015, cash and cash equivalents consisted primarily of deposit accounts and a money market account with a financial institution.

At December 31, 2016, the Organization's deposit accounts exceeded federally insured limits by approximately \$4,247,000.

The premium account is a restricted cash account that holds premiums collected on behalf of Insurance Services.

**American Academy of Family Physicians
Foundation and Subsidiary
Notes to Consolidated Financial Statements
December 31, 2016 and 2015**

Investments and Investment Return

Investments in equity securities having a readily determinable fair value and in all debt securities are carried at fair value. Investment return includes dividend, interest and other investment income; realized and unrealized gains and losses on investments carried at fair value; and realized gains and losses on other investments.

The pooled investment funds are valued at net asset value which estimates fair value. Investment earnings are allocated monthly on a pro rata basis representative of the Foundation's overall percentage of the ownership in the fund.

Investment return that is initially restricted by donor stipulation and for which the restriction will be satisfied in the same year is recorded as temporarily restricted and then released from restriction. Other investment return is reflected in the statement of activities as unrestricted, temporarily restricted or permanently restricted based upon the existence and nature of any donor or legally imposed restrictions.

The Foundation maintains pooled investment accounts for its endowments. Investment income and realized and unrealized gains and losses from securities in the pooled investment accounts are allocated monthly to the individual endowments based on the relationship of the fair value of the interest of each endowment to the total fair value of the pooled investments accounts, as adjusted for additions to or deductions from those accounts.

Investment securities are exposed to various risks such as interest rate, market and credit. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such change could materially affect the amounts reported in the accompanying consolidated statement of financial position.

Accounts Receivable

Foundation accounts receivable consist primarily of Foundation donations collected by the Academy, and donations or grants receivable from third parties. Balances become past due according to the terms of various agreements with third parties and organizations who handle the initial processing. Balances that are still outstanding after management has used reasonable collection efforts are charged to expense when that determination is made. Management believes that all accounts receivable are collectible at December 31, 2016 and 2015; therefore, no allowance for uncollectible accounts has been established.

Insurance Services accounts receivable consist primarily of commissions due from one insurance carrier. Insurance Services holds the funds of these accounts receivable and, accordingly, believes that no allowance for doubtful accounts is needed for the years ended December 31, 2016 and 2015. The insurance carrier and the insured are located throughout the United States of America.

**American Academy of Family Physicians
Foundation and Subsidiary
Notes to Consolidated Financial Statements
December 31, 2016 and 2015**

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation. Depreciation is charged to expense using the straight-line method over the estimated useful life of each asset. The estimated useful lives of the assets range from three years to fifteen years.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Foundation has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Foundation in perpetuity.

Contributions

Gifts of cash and other assets received without donor stipulations are reported as unrestricted revenue and net assets. Gifts received with a donor stipulation that limits their use are reported as temporarily or permanently restricted revenue and net assets. When a donor stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. Gifts and investment income that are originally restricted by the donor, and for which the restriction is met in the same time period, are recorded as temporarily restricted and then released from restriction.

Conditional gifts depend on the occurrence of a specified future and uncertain event to bind the potential donor and are recognized as assets and revenue when the conditions are substantially met and the gift becomes unconditional.

There were no individually significant contributions in 2016 and 2015.

Grant Awards Payable

Grant awards payable include amounts due to outside organizations from grants the Foundation has awarded.

Grant Revenue and Deferred Revenue

Support funded by grants is recognized as the Foundation performs the contracted services or incurs outlays eligible for reimbursement under the grant agreements. Grant activities and outlays are subject to audit and acceptance by the granting agency and, as a result of such audit, adjustments could be required.

**American Academy of Family Physicians
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Notes to Consolidated Financial Statements
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Insurance Revenues

Revenues are based upon broker and service agreements between Insurance Services and the insurance companies that provide coverage. Commissions and administrative allowances are accrued on premiums collected in the period earned.

Income Taxes

The Foundation is exempt from income taxes under Section 501 of the Internal Revenue Code and a similar provision of state law. However, the Foundation is subject to federal income tax on any unrelated business taxable income.

The Organization files tax returns in the U.S. federal jurisdiction.

Insurance Services is a for-profit entity. Income taxes are provided for the tax effects of transactions reported in the consolidated financial statements and consist of taxes currently due and deferred taxes. Deferred taxes are recognized for differences between the basis of assets or liabilities for financial statement and income tax purposes and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

The differences relate to depreciable assets (use of different depreciation methods and lives for financial statements and income tax purposes) and certain accrued expenses (expensed for financial statement purposes but not deductible for income tax purposes until paid). The deferred tax asset and liability represent the future tax return consequences of those differences, which will either be deductible or taxable when the assets or liabilities are recovered or settled. Valuation allowances are provided for deferred tax assets based on management's projection of the sufficiency of future taxable income to realize the assets.

Income tax accounting guidance (ASC Topic 740, *Income Taxes*) requires that the Organization record a liability for uncertain tax positions when it is more likely than not that a tax position would not be sustained if examined by the taxing authority. Insurance Services continually evaluates expiring statutes of limitations, audits, proposed settlements, changes in tax law and new authoritative rulings.

Advertising

Insurance Services expenses advertising and other promotional costs as they are incurred. These types of expenses for mailing campaigns, newsletters and similar activities were approximately \$543,000 and \$713,000 for the years ended December 31, 2016 and 2015, respectively.

Reclassifications

Certain reclassifications have been made to the 2015 financial statements to conform to the 2016 financial statement presentation. These reclassifications had no effect on the change in net assets.

**American Academy of Family Physicians
Foundation and Subsidiary**
Notes to Consolidated Financial Statements
December 31, 2016 and 2015

Subsequent Events

Subsequent events have been evaluated through the date of the Independent Auditor's Report, which is the date the consolidated financial statements were available to be issued.

Note 2: Investments and Investment Return

Investments at December 31 consisted of the following:

	<u>2016</u>	<u>2015</u>
Money markets accounts	\$ 408,339	\$ 452,225
Common and preferred stock	6,365,906	6,970,672
Equity mutual funds	2,891,949	1,993,076
Fixed income mutual funds	1,053,552	878,675
Corporate bonds	1,638,452	1,554,182
Treasury and federal agency obligations	1,623,054	1,762,830
Pooled investment funds	1,255,080	1,173,557
Hedge fund	8,991	14,260
	<u>\$ 15,245,323</u>	<u>\$ 14,799,477</u>

Total investment return is comprised of the following:

	<u>2016</u>	<u>2015</u>
Interest and dividend income	\$ 303,165	\$ 410,769
Realized gains	196,827	627,945
Unrealized gains (losses)	439,153	(940,617)
Investment fees and expenses	(82,632)	(87,958)
Change in value of split-interest agreements	10,597	(4,753)
	<u>\$ 867,110</u>	<u>\$ 5,386</u>

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Foundation and Subsidiary
Notes to Consolidated Financial Statements
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Note 3: Split-Interest Agreements

Charitable Remainder Trusts

The Foundation is the beneficiary of two charitable remainder unitrusts. The trusts provide for a lifetime benefit to be paid to the donor or other designated beneficiary. Upon the death of the beneficiaries, the remaining trust assets are distributed in accordance with the trust document.

The Foundation is the trustee and sole remainder beneficiary of one of the trusts. The fair values of the trust assets were \$46,046 and \$46,733 as of December 31, 2016 and 2015, respectively, and are included in investments in the Foundation's consolidated statement of financial position. The Foundation has recorded a liability at December 31, 2016 and 2015, of \$28,387 and \$29,650, respectively, which represents the present value of the future obligations to make distributions to the designated beneficiaries.

The second trust is administered by an outside party. Therefore, the estimated value of the expected future cash flows of \$54,593 and \$53,536, which represents the fair value of the trust assets at December 31, 2016 and 2015, respectively, is recorded as "beneficial interest in trust assets" on the consolidated statement of financial position.

Pooled Income Fund

The Foundation manages a pooled income fund in which donors who contribute to the fund are assigned a specific number of units based on the proportion of the fair value of their contribution to the total fair value of the pooled income fund. Until the donor's death, the donor or the donor's designated beneficiary is paid the actual ordinary income earned on the donor's units. Upon the donor's death, the value of the assigned units reverts to the Foundation.

The Foundation recognizes its remainder interest in the assets received as temporarily restricted contribution revenue in the period in which the assets are received from the donor. The contributed assets are recognized at fair value when received. The difference between the fair value of the assets when received and the revenue recognized is recorded as deferred revenue, representing the amount of discount for future interest.

The fair value of the pooled income fund assets was \$101,534 and \$96,676 as of December 31, 2016 and 2015, respectively, and is included in "investments" in the consolidated statement of financial position. The present value of the estimated future payments is calculated using a discount rate ranging from 5.75% to 8.75% and applicable life expectancy tables. The estimated future liability of the pooled income fund was \$34,237 and \$34,988 as of December 31, 2016 and 2015, respectively, and is included in "liabilities under split-interest agreements" in the consolidated statement of financial position.

**American Academy of Family Physicians
Foundation and Subsidiary
Notes to Consolidated Financial Statements
December 31, 2016 and 2015**

Charitable Gift Annuity

The Foundation has been the recipient of a gift annuity which requires future payments to the donor or their named beneficiaries. The assets received from the donor are recorded at fair value. The Foundation has recorded a liability at December 31, 2016 and 2015 of \$135,223 and \$0, respectively, which represents the present value of the future annuity obligations. The liability had been determined using a discount rate of 1.8% and a rate of return of 4.4%. Contribution revenue recognized under the agreement was \$176,800 and \$0 for the years ended December 31, 2016 and 2015, respectively.

Note 4: Net Assets

Board-Designated Net Assets

Certain net assets have been designated by the Board for the following purposes:

	<u>2016</u>	<u>2015</u>
General endowment	\$ 8,783,600	\$ 9,106,149
Center for the History of Family Medicine endowment	1,116,692	1,036,868
Panther endowment	36,008	34,028
Total board-designated endowments	<u>9,936,300</u>	<u>10,177,045</u>
Family Medicine Cares USA	-	17,490
Family Medicine Philanthropic Consortium	108,637	116,849
Research committee mentorships	<u>15,366</u>	<u>15,366</u>
	<u>\$ 10,060,303</u>	<u>\$ 10,326,750</u>

**American Academy of Family Physicians
Foundation and Subsidiary
Notes to Consolidated Financial Statements
December 31, 2016 and 2015**

Temporarily Restricted Net Assets

Temporarily restricted net assets at December 31 are available for the following purposes:

	<u>2016</u>	<u>2015</u>
Resident Service Award	\$ 461,059	\$ 467,431
Center for the History of Family Medicine	485,567	408,236
Family Medicine Cares	55,180	45,890
Family Medicine Leads	82,709	81,943
Stern Lectureship	108,141	103,696
Special projects	100,796	110,109
Charitable remainder trusts	61,958	57,234
Pooled income fund	67,297	61,688
Disaster relief fund	57,366	43,068
Ruth Ostergaard Children's Fund	21,416	20,577
Immunization program	7,216	7,216
Other	81,775	63,673
	<u>\$ 1,590,480</u>	<u>\$ 1,470,761</u>

**American Academy of Family Physicians
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Permanently Restricted Net Assets

Permanently restricted net assets at December 31 are restricted to:

	<u>2016</u>	<u>2015</u>
Investment in perpetuity, the income of which is expendable to support		
Family Medicine Leads Scholarships (McCord endowment)	\$ 123,938	\$ 118,034
Ruth Ostergaard Children's Fund	102,813	100,488
Robert Graham Center	407,823	405,174
Family Medicine Leads (Lopez endowment)	87,985	87,985
Research (Lopez Pollina endowment)	117,569	111,101
Fellowship in the History of Family Medicine (Panther endowment)	20,726	19,369
Family Medicine Residents and Students (Walters endowment)	52,674	-
Investment in perpetuity, the income of which is expendable upon board approval to support		
Center for the History of Family Medicine	960,237	916,451
Charitable remainder trusts	13,648	13,384
	<u>\$ 1,887,413</u>	<u>\$ 1,771,986</u>

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Net Assets Released from Restrictions

Net assets were released from donor restrictions by incurring expenses satisfying the restricted purposes or by occurrence of other events by donors.

	<u>2016</u>	<u>2015</u>
Peers for Progress	\$ -	\$ 804,713
Cities for Life	-	60,851
Special projects	522,653	297,814
Family Medicine Cares	101,480	89,586
Family Medicine Leads	97,000	75,257
Immunization program	129,965	159,157
Disaster relief	1,589	32,638
Highlight on Diabetes	6,533	-
Resident Service Award	33,000	16,500
Stern Lectureship	1,500	1,439
Ruth Ostergaard Children's Fund	6,200	3,410
Other	5,743	3,358
	<u>\$ 905,663</u>	<u>\$ 1,544,723</u>

Note 5: Endowment

The Foundation's endowment consists of eight individual funds established for a variety of purposes. The endowment includes both donor-restricted endowment funds and funds designated by the governing body to function as endowments (board-designated endowment funds). As required by accounting principles generally accepted in the United States of America (GAAP), net assets associated with endowment funds, including board-designated endowment funds, are classified and reported based on the existence or absence of donor-imposed restrictions.

The Foundation's governing body has interpreted the State of Kansas Prudent Management of Institutional Funds Act (KPMIFA) as requiring preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Foundation classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of donor-restricted endowment funds is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Foundation in a manner consistent with the standard of prudence prescribed by KPMIFA. In accordance with KPMIFA, the Foundation considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

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1. Duration and preservation of the fund
2. Purposes of the Foundation and the fund
3. General economic conditions
4. Possible effect of inflation and deflation
5. Expected total return from investment income and appreciation or depreciation of investments
6. Other resources of the Foundation
7. Investment policies of the Foundation

The composition of net assets by type of endowment fund at December 31, 2016 and 2015, was:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
December 31, 2016				
Donor-restricted	\$ -	\$ 550,093	\$ 1,873,765	\$ 2,423,858
Board-designated	9,936,300	-	-	9,936,300
	<u>9,936,300</u>	<u>-</u>	<u>-</u>	<u>9,936,300</u>
Total endowment funds	<u>\$ 9,936,300</u>	<u>\$ 550,093</u>	<u>\$ 1,873,765</u>	<u>\$ 12,360,158</u>
December 31, 2015				
Donor-restricted	\$ -	\$ 448,091	\$ 1,758,727	\$ 2,206,818
Board-designated	10,177,045	-	-	10,177,045
	<u>10,177,045</u>	<u>-</u>	<u>-</u>	<u>10,177,045</u>
Total endowment funds	<u>\$ 10,177,045</u>	<u>\$ 448,091</u>	<u>\$ 1,758,727</u>	<u>\$ 12,383,863</u>

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Changes in endowment net assets for the years ended December 31, 2016 and 2015 were:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, January 1, 2015	\$ 11,312,494	\$ 469,994	\$ 1,655,754	\$ 13,438,242
Investment return				
Investment income	229,477	41,923	3,123	274,523
Net appreciation (depreciation)	<u>(216,685)</u>	<u>(59,816)</u>	<u>15,145</u>	<u>(261,356)</u>
Total investment return	<u>12,792</u>	<u>(17,893)</u>	<u>18,268</u>	<u>13,167</u>
Contributions	60,625	-	84,705	145,330
Appropriation of endowment assets for expenditures	(800,000)	(4,010)	-	(804,010)
Other transfers	<u>(408,866)</u>	<u>-</u>	<u>-</u>	<u>(408,866)</u>
Endowment net assets, December 31, 2015	<u>10,177,045</u>	<u>448,091</u>	<u>1,758,727</u>	<u>12,383,863</u>
Investment return				
Investment income	141,895	28,979	1,045	171,919
Net appreciation	<u>439,761</u>	<u>84,823</u>	<u>13,484</u>	<u>538,068</u>
Total investment return	<u>581,656</u>	<u>113,802</u>	<u>14,529</u>	<u>709,987</u>
Contributions	590	-	100,509	101,099
Appropriation of endowment assets for expenditures	(367,325)	(11,800)	-	(379,125)
Other transfers	<u>(455,666)</u>	<u>-</u>	<u>-</u>	<u>(455,666)</u>
Endowment net assets, December 31, 2016	<u>\$ 9,936,300</u>	<u>\$ 550,093</u>	<u>\$ 1,873,765</u>	<u>\$ 12,360,158</u>

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Amounts of donor-restricted endowment funds classified as permanently and temporarily restricted net assets at December 31 consisted of:

	2016	2015
Permanently restricted net assets		
Portion of perpetual endowment funds required to be retained permanently by explicit donor stipulation or KPMIFA	<u>\$ 1,873,765</u>	<u>\$ 1,758,727</u>
Temporarily restricted net assets		
Portion of perpetual endowment funds subject to a time restriction under KPMIFA with purpose restrictions	<u>\$ 550,093</u>	<u>\$ 448,091</u>

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level the Foundation is required to retain as a fund of perpetual duration pursuant to donor stipulation or KPMIFA. In accordance with GAAP, deficiencies of this nature are reported in unrestricted net assets. There were no deficiencies of this nature at December 31, 2016 and 2015.

The Foundation has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs and other items supported by its endowment while seeking to maintain the purchasing power of the endowment. Endowment assets include those assets of donor-restricted endowment funds the Foundation must hold in perpetuity or for donor-specified periods, as well as those of board-designated endowment funds. Under the Foundation's policies, endowment assets are invested in a manner that is intended to grow the principal of the funds while assuming a tolerable level of investment risk. The Foundation expects its endowment funds to provide an average rate of return of approximately 7.5% annually over time. Actual returns in any given year may vary from this amount.

To satisfy its long-term rate of return objectives, the Foundation relies on a total return strategy in which investment returns are achieved through both current yield (investment income such as dividends and interest) and capital appreciation (both realized and unrealized). The Foundation targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

When specified, the Foundation follows the donor's stipulations in the endowment agreement regarding the appropriation of endowment earnings. For board-designated funds, earnings are being reinvested until determined expendable by the board. For donor funds, earnings are being reinvested until the endowment reaches a point that the earnings would support the intended purpose of the endowment in perpetuity.

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Note 6: Conditional Grants

In May 2007, the Foundation entered into an agreement with Eli Lilly and Company Foundation, Inc. (Lilly) whereby Lilly agreed to grant \$15 million to the Foundation to support the development of the “Peers for Progress” program (PFP). PFP is designed to help the diabetes community establish a new model of peer education for people with diabetes. The program is rooted in peer-to-peer interactions in order to sustain individual behavior changes that will improve health as well as quality of life. PFP is designed to demonstrate the value of peer support, extend the evidence base for such interventions, help establish peer support as an accepted, core component of diabetes care, and promote peer support programs and networks around the world.

In December 2010, the Foundation entered into a grant agreement with Bristol-Myers Squibb Foundation, Inc. that provides for a grant of up to \$5,239,876 in three annual payments, in support of a demonstration project to be led by the PFP management team. The grant expired March 31, 2015.

These grants are cancellable by the grantors at any time with or without cause with unexpended or uncommitted advances to be refunded. The Foundation retains a 5% fee for administering the grants. Through December 31, 2016, the Foundation had received \$20,104,187 under these grant agreements and \$20,036,440 in expenses had been incurred. During 2015, \$135,433 was refunded back to Bristol-Myers Squibb Foundation, Inc. for unexpended grant funds. The balance of \$67,747 and \$144,414 is included in deferred revenue at December 31, 2016 and 2015, respectively.

Note 7: Related-Party Transactions

The Organization and the Academy are related parties that are not financially interrelated organizations.

The Academy provides certain services to the Foundation under an administrative services agreement. The administrative services agreement includes services such as day-to-day executive, administrative, legal, accounting, clerical and other services in connection with the operations of the Foundation. The Foundation reimburses the Academy for direct costs under the agreement. In addition, the Foundation pays the Academy an additional service fee equal to 22.2% of the annual direct costs. Fees paid under the administrative services agreement were \$1,925,198 and \$1,893,287 for 2016 and 2015, respectively. The Foundation also paid \$479,059 in 2016 and \$637,889 in 2015 for grants and related costs to the Academy.

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The following amounts were provided to the Foundation as support from, or pass-through donations collected by, the Academy for the years ended December 31:

	2016	2015
Dues check-off (pass through donations)	\$ 204,068	\$ 221,163
Contributions directed through the Academy	52,043	48,628
Center for the History of Family Medicine support	15,000	15,000
Other	69,295	70,060
	\$ 340,406	\$ 354,851

Foundation accounts receivable included revenues and other support from the Academy of \$52,900 and \$58,091 at December 31, 2016 and 2015, respectively. Accounts payable include \$716,226 and \$731,224 at December 31, 2016 and 2015, respectively, due to the Academy by the Foundation for services and other items.

Insurance Services remitted reimbursements to the Academy for common administrative costs (postage, internet, telephone) and marketing expenses in the amount of \$160,453 and \$188,500 in 2016 and 2015, respectively. The amount due to the Academy was \$22,354 and \$0 as of December 31, 2016 and 2015, respectively, for these common administrative and marketing expenses.

The Academy, as the contract holder, controls certain plans administered by Insurance Services. Insurance Services administers Academy-sponsored life insurance plans and, pursuant to a royalty agreement relating thereto, incurred costs to the Academy of \$75,742 and \$67,653 for the years ended December 31, 2016 and 2015, respectively.

Note 8: Operating Leases

Insurance Services entered into a noncancellable operating lease for office space with the Academy, which expires in 2019. This lease requires Insurance Services to pay additional rent, to be determined annually, for related operating expenses, taxes and other rent provisions. Rental payments include minimum rentals, plus a fixed monthly fee for certain utilities.

Future minimum lease payments at December 31, 2016 were:

2017	\$ 77,248
2018	78,880
2019	53,312
	\$ 209,440

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Rent expense under this operating lease was \$75,616 and \$73,984, respectively, for the years ended December 31, 2016 and 2015.

Note 9: Income Taxes

The provision for federal and state income taxes consists of the following components for the years ended December 31:

	<u>2016</u>	<u>2015</u>
Current expense	\$ 689,400	\$ 669,715
Deferred benefit (expense)	<u>1,600</u>	<u>(900)</u>
Total income tax expense	<u>\$ 691,000</u>	<u>\$ 668,815</u>

A reconciliation of income tax expense at the statutory rate to the Company's actual income tax expense is shown below:

	<u>2016</u>	<u>2015</u>
Computed at the statutory rate (34%)	\$ 609,042	\$ 588,766
Increase (decrease) resulting from		
Nondeductible meals and entertainment	502	1,077
State income taxes - net of federal tax benefit	81,651	79,107
Other	<u>(195)</u>	<u>(135)</u>
Actual tax provision	<u>\$ 691,000</u>	<u>\$ 668,815</u>

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The tax effects of temporary differences related to deferred taxes shown on the consolidated statement of financial position were:

	<u>2016</u>	<u>2015</u>
Deferred tax assets		
Accrued vacation	\$ 34,900	\$ 35,900
Deferred tax liability		
Book/tax difference on fixed assets	<u>(12,000)</u>	<u>(11,400)</u>
Net deferred tax asset	<u>\$ 22,900</u>	<u>\$ 24,500</u>

The above net deferred tax asset is presented on the consolidated statement of financial position as follows:

	<u>2016</u>	<u>2015</u>
Deferred tax asset	\$ 34,900	\$ 35,900
Deferred tax liability	<u>(12,000)</u>	<u>(11,400)</u>
Net deferred tax asset	<u>\$ 22,900</u>	<u>\$ 24,500</u>

Note 10: Profit Sharing Plan and 401(k) Plan

Insurance Services administers a non-contributory, defined contribution retirement plan (the Defined Contribution Plan) for its employees. All employees who have attained the age of 21 and completed 1,000 hours of service during a 12-month period are eligible. The right to discontinue the Defined Contribution Plan has been reserved by Insurance Services and, in such event, the trust fund must be used for the exclusive benefit of participants. Insurance Services' annual contribution for the Defined Contribution Plan is seven percent (7%) of each participant's annual salary. Additionally, Insurance Services has a 401(k) plan and Insurance Services matches employee contributions up to an additional four percent (4%) of compensation. Insurance Services contributed \$84,813 and \$81,083 to the plans in 2016 and 2015, respectively.

Retirement benefits for the Foundation are provided under the administrative services agreement with the Academy.

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Note 11: Functional Expenses

The costs of supporting activities have been allocated to the various programs in the consolidated statement of activities. Expenses summarized on a functional basis are shown below. Certain costs have been allocated among the program, administration and fundraising categories based on time expended, usage and other methods.

	<u>2016</u>	<u>2015</u>
Foundation		
Program services	\$ 3,044,298	\$ 3,746,440
Administration	472,109	457,972
Fundraising	942,717	858,392
Insurance Services	<u>2,821,965</u>	<u>2,951,985</u>
	<u>\$ 7,281,089</u>	<u>\$ 8,014,789</u>

Note 12: Disclosures About Fair Value of Assets and Liabilities

Fair value is 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. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

- Level 1** Quoted prices in active markets for identical assets or liabilities
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities
- Level 3** Unobservable inputs supported by little or no market activity and are significant to the fair value of the assets or liabilities

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Recurring Measurements

The following tables present the fair value measurements of assets recognized in the accompanying consolidated statement of financial position measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at December 31, 2016 and 2015:

	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2016				
Investments				
Money markets accounts	\$ 408,339	\$ 408,339	\$ -	\$ -
Common and preferred stock	6,365,906	6,365,906	-	-
Equity mutual funds	2,891,949	2,891,949	-	-
Fixed income mutual funds	1,053,552	1,053,552	-	-
Corporate bonds	1,638,452	-	1,638,452	-
Treasury and federal agency obligations	1,623,054	-	1,623,054	-
Pooled investment funds	1,255,080	-	1,255,080	-
Hedge fund	8,991	-	-	8,991
Beneficial interest in trust assets	54,593	-	54,593	-
	<u>\$ 15,299,916</u>	<u>\$ 10,719,746</u>	<u>\$ 4,571,179</u>	<u>\$ 8,991</u>

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	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2015				
Investments				
Money markets accounts	\$ 452,225	\$ 452,225	\$ -	\$ -
Common and preferred stock	6,970,672	6,970,672	-	-
Equity mutual funds	1,993,076	1,993,076	-	-
Fixed income mutual funds	878,675	878,675	-	-
Corporate bonds	1,554,182	-	1,554,182	-
Treasury and federal agency obligations	1,762,830	-	1,762,830	-
Pooled investment funds	1,173,557	-	1,173,557	-
Hedge fund	14,260	-	-	14,260
Beneficial interest in trust assets	53,536	-	53,536	-
	<u>\$ 14,853,013</u>	<u>\$ 10,294,648</u>	<u>\$ 4,544,105</u>	<u>\$ 14,260</u>

Following is a description of the valuation methodologies and inputs used for assets and measured at fair value on a recurring basis and recognized in the accompanying consolidated statement of financial position, as well as the general classification of such assets and liabilities pursuant to the valuation hierarchy. There have been no significant changes in the valuation techniques during the year ended December 31, 2016.

Investments

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using quoted prices of securities with similar characteristics or independent asset pricing services and pricing models, the inputs of which are market-based or independently sourced market parameters, including, but not limited to, yield curves, interest rates, volatilities, prepayments, defaults, cumulative loss projections and cash flows. Such securities are classified in Level 2 of the valuation hierarchy. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy.

The value of certain investments, classified as pooled investments and hedge fund, is determined using net asset value (or its equivalent) as a practical expedient. The pooled investment fund invests primarily in publicly traded mutual funds and a limited partnership. Investment income and realized and unrealized gains and losses from securities in the pooled investment fund are allocated monthly to the fund partners based on the relationship of the fair value of the interest of each partner's account to the total fair value of the pooled investment fund, as adjusted for additions to

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or deductions from those accounts. The Foundation has the ability to redeem the pooled investments at any time and has, therefore, categorized these investments as Level 2. The underlying investments of the hedge fund include a portfolio of alternative investments funds. The hedge fund is currently in liquidation with expected payouts through 2018. As the hedge fund is invested in alternative investment funds without observable inputs, the Foundation has categorized the investment as Level 3.

Fair value determinations for Level 3 measurements of securities are the responsibility of management. Management challenges the reasonableness of the assumptions used and reviews the methodology to ensure the estimated fair value complies with accounting standards generally accepted in the United States.

Beneficial Interest in Trust Assets

Fair value is estimated at the present value of the future distributions expected to be received over the term of the agreement. Due to the nature of the valuation inputs, the interest is classified within Level 2 of the hierarchy.