

Patient-Centered Outcomes Research Institute

Financial Report
December 31, 2011

Contents

Independent Auditor's Report	1 – 2
Management's Discussion and Analysis	3 – 7
Financial Statements	
Statements of Financial Position	8
Statements of Activities	9
Statements of Cash Flows	10
Statements of Functional Expenses	11 – 12
Notes to Financial Statements	13 – 16
Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i>	17 – 18



Independent Auditor's Report

To the Audit Committee
Patient-Centered Outcomes Research Institute
Washington, D.C.

We have audited the accompanying statements of financial position of Patient-Centered Outcomes Research Institute (PCORI) as of December 31, 2011 and 2010, and the related statements of activities, cash flows, and functional expenses for the year ended December 31, 2011, and for the period from November 10, 2010 (Inception) through December 31, 2010. These financial statements are the responsibility of PCORI'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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 PCORI's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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 Patient-Centered Outcomes Research Institute as of December 31, 2011 and 2010, and the changes in its net assets and its cash flows for the year ended December 31, 2011, and for the period from November 10, 2010 (Inception) through December 31, 2010, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated, April 20, 2012, on our consideration of PCORI's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Management's Discussion and Analysis, on pages 3 – 7, is not a required part of the basic financial statements but is supplementary information to the financial statements under accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information in conformity with the financial statements. However, we did not audit the information and express no opinion on it.

McGladrey & Pullen, LLP

Vienna, Virginia
April 20, 2012

Patient-Centered Outcomes Research Institute

Management's Discussion and Analysis

The Patient-Centered Outcomes Research Institute (PCORI) was established by federal law (42 U.S.C. 1301 et. seq.) in 2010 to conduct research to provide information about the best available evidence to help patients and their health care providers make more informed decisions. PCORI's research is intended to give patients a better understanding of the prevention, treatment, and care options available and the science that supports those options.

PCORI is unique both in its mission and how it seeks to fulfill it. PCORI helps people make informed health care decisions – and improves health care delivery and outcomes – by producing and promoting high integrity, evidence-based information that comes from research guided by patients, caregivers, and the broader health care community.

PCORI is a 501(c)(1) non-profit corporation, governed by a 21-member Board of Governors, including the Director of the Agency for Healthcare Research and Quality (AHRQ), the Director of the National Institutes of Health (NIH), and 19 members appointed by the Comptroller General of the United States. By law, the Comptroller must appoint three members representing patients and healthcare consumers, seven members representing physicians and providers, three members representing private payers, three members representing pharmaceutical, device, and diagnostic manufacturers or developers, one member representing quality improvement or independent health services researchers, and two members representing the federal government or the states (including at least one member representing a federal health program or agency).

Organizational Structure and Stakeholder Collaboration: PCORI has worked throughout the past year to build a major national health research institute from the ground up, utilizing a rigorous stakeholder-driven process that emphasizes ongoing patient engagement. This work is driven by PCORI's Board, while a 17-member Methodology Committee works to develop and advance the science and methodologies of comparative clinical effectiveness research. Members of the Methodology Committee are experts in their fields of endeavor, including but not limited to health services research, clinical research, comparative clinical effectiveness research, biostatistics, genomics, and research methodologies. PCORI's Board and Methodology Committee have established a number of committees to provide focus for key areas of its work.

Board Committees

- Communications, Outreach, and Engagement
- Program Development
- Finance, Audit, and Administration

Methodology Committee Working Groups

- Patient-Centeredness
- Research Prioritization
- Research Methods
- Report Assimilation

Special Committees

- Dissemination Work Group
- Scientific Publications
- Standing Committee on Conflicts of Interest
- Pilot Project Selection

Patient-Centered Outcomes Research Institute

Management's Discussion and Analysis

During 2011, the Board established an initial organizational framework, hired an executive director, developed a consensus on PCORI's mission, and delineated processes for defining Patient-Centered Outcomes Research (PCOR), proposing National Research Priorities, establishing a Research Agenda, and producing a methodology report. These efforts have been guided by the mission statement that the Board adopted in July 2011:

"PCORI helps people make informed healthcare decisions – and improves healthcare delivery and outcomes – by producing and promoting high-integrity, evidence-based information that comes from research guided by patients, caregivers, and the broader healthcare community."

This guidance and the involvement of patients and other health care system stakeholders in all phases of research are not only distinguishing characteristics of PCORI's mission – they are essential to broad acceptance of the evidence-based information the research is intended to produce.

Current Activities: PCORI has worked continuously to advance its mission by ensuring transparency, credibility, and access in all aspects of its operations. PCORI uses a variety of forums and public comment periods to obtain public input to guide its work. The Board holds open Board meetings every other month, many of them featuring community engagement activities. Board and Methodology Committee members have met with patients, caregivers, and dozens of organizations representing nursing disciplines, medical specialties, medical technology and research fields, as well as patient-advocacy groups. In addition, PCORI has regularly engaged patients, caregivers, clinicians, and others through a series of focus groups on various aspects of its work. The following focus groups were held in the past year:

1. Defining Patient-Centered Outcomes Research
2. Pilot Projects Program
3. Developing National Priorities for Research and a Research Agenda
4. Developing PCORI's First Methodology Report
5. Funding Research

Defining Patient-Centered Outcomes Research

One of PCORI's foundational tasks was to clearly describe the field of "patient-centered outcomes research," something not formally defined at the time PCORI was established, as a means of clarifying PCORI's focus and scope of work. This was accomplished through a year-long iterative and transparent process that included a public comment period that generated feedback from nearly 120 organizations and 450 individuals. Additional public input was sought through six focus groups involving patients, caregivers, and the general public. A revised draft was adopted by PCORI's Board in March 2012.

Pilot Projects Program

PCORI developed its Pilot Projects Program to fund \$26 million in research over two years that would focus on eight areas of interest. The goals for the two-year program are to help establish national priorities for research, the development of PCORI's research agenda, and support the creation of new methods and data collection to advance patient-centered outcomes research. Following a public input period to assess the program's eight proposed focus areas, PCORI issued a request for applications promoting observational methodologies, systematic reviews, mixed methods and qualitative methodologies, simulations, small pragmatic pilot trials, and survey methods. This request generated nearly 1,400 letters of intent and nearly 850 applications. Merit reviews took place in the first quarter of 2012, and a selection committee comprised of Board members will be preparing a recommended slate of projects for funding consideration. The Board intends to announce awards by May.

Patient-Centered Outcomes Research Institute

Management's Discussion and Analysis

Developing National Priorities for Research and a Research Agenda

PCORI must establish National Priorities for Research and a Research Agenda before it can fund primary research. The process of drafting these research roadmaps began in August 2011 under the aegis of the Program Development Committee, which conducted an extensive review of nine previous national efforts to prioritize comparative effectiveness research. The review identified ten common themes that consistently appeared as priority areas for research. These were measured against PCORI's working definition of patient-centered outcomes research to determine five cross-cutting areas that became the PCORI priorities for research. Using the draft priorities as a foundation, the Committee developed an initial research agenda by applying the criteria for research provided in PCORI's establishing legislation. The priorities and agenda were written to be intentionally broad and do not name specific conditions or treatments that PCORI will examine. This approach recognizes that there are many important research questions to be answered and focusing on a narrow set of conditions at the start of PCORI's research funding would exclude certain patients at a very early stage in PCORI's work.

PCORI began incorporating patient and other stakeholder perspectives early in the process, using the experience of the Board and a series of informal meetings with organizations representing patients, as well as other stakeholders, to ensure that the drafts developed for public comment were informed by the health care community. Patient and caregiver focus groups were conducted to provide early input on the developing priorities, and PCORI executive staff and Board members discussed the process with numerous stakeholder organizations, including patient representatives. PCORI released its draft priorities and research agenda for public comment in January 2012, soliciting feedback through a national dialogue event held in Washington, D.C., clinician focus groups, a web-based survey tool, and print and online advertisements placed in a wide range of consumer and professional media.

After reviewing the feedback received, PCORI will publish a report that summarizes the input and subsequent recommendations for changes to the draft priorities and agenda. The Board will consider a revised set of proposed priorities and an agenda during a public teleconference in April, preparatory to issuing initial funding announcements in May.

Developing PCORI's First Methodology Report

The Methodology Committee conducted activities during 2011 that laid the groundwork to prepare methodological standards for comparative clinical effectiveness and patient-centered outcomes research and a translation table that will provide guidance to the Board in determining which research methods should be used to address specific research questions. Four working groups: Patient-Centeredness, Research Priorities, Research Methods, and Report Assimilation, were established to guide the work. The Committee issued a Request for Information (RFI) to solicit input from methodologists on the translation table. The RFI resulted in the submission of 24 responses, including 17 case studies. The Committee developed requests for proposals to (1) review guidance on selected research methods; (2) review and synthesize evidence for eliciting the patient's perspective in patient-centered outcomes research (through literature review and expert stakeholder interviews); and (3) develop white papers on methods for setting priorities in research. The Committee oversaw a rigorous proposal review process that resulted in the execution of 15 awards to leading research organizations from across the country during 2011. The Committee is in the process of using the reports from these awards to develop the first set of standards that will be in the first Methodology Report, to be submitted to the Board on May 10, 2012.

Funding Research in 2011

PCORI will make a variety of external funding opportunities available throughout the course of its work. In 2011, the Institute funded 15 contracts in response to Requests for Proposals (RFPs) across three areas to support the development of PCORI's first Methodology Report. PCORI also issued RFPs for an analysis of the public input received on the working definition of "patient-centered outcomes research" and to conduct patient and caregiver focus groups to ensure the definition resonates with the ultimate beneficiaries of PCORI's work.

Patient-Centered Outcomes Research Institute

Management's Discussion and Analysis

PCORI RFPs are awarded through a competitive process. Calls for proposals are published on PCORI's website in the Funding Announcements section (<http://www.pcori.org/funding-opportunities/>) and distributed by email to PCORI's opt-in email list. Proposals that are submitted after an RFP are considered in a careful review process that includes:

- Excluding reviewers with a conflict-of-interest
- Scientific review by a small review committee that includes Methodology Committee members and Board members
- The opportunity for review by the full Methodology Committee
- A final decision by the Executive Director

The results of all funded projects, upon completion, are to be published on the PCORI website.

Financial Highlights: \$1.26 billion was appropriated for the Patient-Centered Outcomes Research Trust Fund (PCORTF) in 2010; \$10 million for fiscal year 2010, \$50 million for fiscal year 2011, and \$150 million a year for each of the eight years, 2012 through 2019. These amounts, less the annual 20% distribution to AHRQ and HHS beginning in 2011, are available to PCORI without further appropriation.

PCORI prepares annual financial statements in accordance with U.S. generally accepted accounting principles (GAAP), as issued by the Financial Accounting Standards Board. These statements are audited by independent auditors to ensure their integrity and reliability in assessing performance. The financial statements and notes are presented on a comparative basis.

The following table summarizes the significant changes in PCORI's financial condition during FY 2011:

Financial Condition	FY 2011	FY 2010	Increase	Percentage Difference
Assets	\$ 163,484,540	\$ 49,873,690	\$ 113,610,850	227.8%
Liabilities	\$ 2,513,990	\$ 315,339	\$ 2,198,651	697.2%
Net Assets	\$ 160,970,550	\$ 49,558,351	\$ 111,412,199	224.8%
Revenues	\$ 120,024,106	\$ 50,008,865	\$ 70,015,241	140.0%
Expenses	\$ 8,611,907	\$ 450,514	\$ 8,161,393	1811.6%

Below is a brief description of the nature of each required financial statement and its relevance. Certain significant balances or conditions are explained to elaborate on the impact on PCORI's operations. Readers are encouraged to gain a deeper understanding by reviewing PCORI's financial statements and notes to the accompanying financial statements.

Statements of Financial Position: The accompanying statement of financial position as of December 31, 2011, reports a change in unrestricted net assets of \$111,412,199. Specifically, PCORI's total assets of \$163,484,540 include cash of \$4,483,112. The total assets as of December 31, 2011, increased by \$113,610,850 from December 31, 2010, which is due to the receipt of appropriations. In addition, the increase in total assets reflects the purchase of property and equipment and an increase in prepaid deposits and expenses. PCORI moved its headquarters to a new location on March 30, 2012, and in preparation, PCORI started construction on the new leased space in 2011. The leasehold improvements are reflected in property and equipment, net.

Total liabilities reported are \$2,513,990 as of December 31, 2011, and they represent outstanding obligations. Total liabilities as of December 31, 2011, increased by \$2,198,651 from FY 2010.

Patient-Centered Outcomes Research Institute

Management's Discussion and Analysis

Statements of Activities: In FY 2011, support from appropriations totaled \$120,000,000. The program activities of \$4,439,114 are comprised of the program services of the Communications, Outreach, and Engagement, the Methodology, and the Research Committees. The combination of the revenue minus expenses yielded an excess of revenue over expenses totaling \$111,412,199. In FY 2010, support from appropriations totaled \$50,000,000. Expenses for program activities and support activities were \$620 and \$449,894, respectively, which resulted in revenue over expenses of \$49,558,351.

Statements of Functional Expenses: The \$4,438,494 increase in program services between FY 2011 and FY2010 is primarily due to the development of committees and the work product that resulted. In addition, the increase of \$3,722,899 in administrative and other support services includes an increase in salaries and Director's Compensation, as the Board of Governors began building out the infrastructure, the use of professional services to provide back office support, the development of contracting capacity, and an increase in the cost of daily operations.

Future Events: The PCORI senior management team is fully operational and will continue developing the organization's infrastructure to effectively manage daily operations and accomplish its mission.

Request for Information: This financial report is designed to provide a general overview of PCORI's finances. Questions concerning any of the information provided in this report, or requests for additional financial information, should be addressed to the Patient-Centered Outcomes Research Institute, 1828 L Street, NW, Suite 900, Washington, D.C. 20036. Additional information regarding PCORI's operations can be found at www.pcori.org.

Patient-Centered Outcomes Research Institute

**Statements of Financial Position
December 31, 2011 and 2010**

Assets	2011	2010
Cash	\$ 4,483,112	\$ 234,825
Amounts held by PCOR Trust Fund (Note 2)	158,078,971	49,638,865
Prepaid expenses and deposits	763,304	-
Property and equipment, net (Note 3)	159,153	-
	\$ 163,484,540	\$ 49,873,690
Liabilities and Net Assets		
Liabilities		
Accounts payable and accrued expenses	\$ 2,513,990	\$ 315,339
Total liabilities	2,513,990	315,339
Commitments and contingencies (Notes 2, 3, 4 and 5)		
Net assets		
Unrestricted	160,970,550	49,558,351
	\$ 163,484,540	\$ 49,873,690

The accompanying footnotes are an integral part of these statements.

Patient-Centered Outcomes Research Institute

Statements of Activities

**Year Ended December 31, 2011 and for the Period from November 10, 2010 (Inception)
through December 31, 2010**

	2011	2010
Revenue and support:		
Federal appropriations	\$ 120,000,000	\$ 50,000,000
Interest income	24,106	8,865
Total revenue and support	120,024,106	50,008,865
Expenses:		
Program services:		
Communications, Outreach, and Engagement	1,848,077	620
Methodology	1,410,127	-
Research	1,180,910	-
Supporting services:		
Administrative – general	3,166,048	370,639
Administrative – board	1,006,745	79,255
Total expenses	8,611,907	450,514
Change in net assets	111,412,199	49,558,351
Net assets:		
Beginning	49,558,351	-
Ending	\$ 160,970,550	\$ 49,558,351

The accompanying footnotes are an integral part of these statements.

Patient-Centered Outcomes Research Institute

Statements of Cash Flows

Year Ended December 31, 2011 and for the Period from November 10, 2010 (Inception) through December 31, 2010

	2011	2010
Cash Flows From Operating Activities		
Change in net assets	\$ 111,412,199	\$ 49,558,351
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Changes in assets and liabilities:		
Increase in:		
Amounts held by PCOR Trust Fund	(108,440,106)	(49,638,865)
Prepaid expenses and deposits	(763,304)	-
Accounts payable and accrued expenses	2,187,620	315,339
Net cash provided by operating activities	4,396,409	234,825
Cash Flow From Investing Activities		
Purchases of property and equipment	(148,122)	-
Net cash used in investing activities	(148,122)	-
Net increase in cash	4,248,287	234,825
Cash:		
Beginning	234,825	-
Ending	\$ 4,483,112	\$ 234,825
Supplemental Schedule of Noncash Investing Activities		
Property and equipment included in accounts payable and accrued expenses	\$ 11,031	\$ -

The accompanying footnotes are an integral part of these statements.

Patient-Centered Outcomes Research Institute

**Statement of Functional Expenses
Year Ended December 31, 2011**

	Program Services				Supporting Services			Total
	Communications, Outreach, and Engagement	Methodology	Research	Total Program Services	Administrative – General	Administrative – Board	Total Supporting Services	
Directors' compensation	\$ -	\$ 291,432	\$ -	\$ 291,432	\$ -	\$ 452,878	\$ 452,878	\$ 744,310
Salaries & wages – other	82,521	61,870	65,239	209,630	69,128	-	69,128	278,758
Other professional services	1,067,103	665,380	359,824	2,092,307	1,008,159	-	1,008,159	3,100,466
Management fees	479,979	130,967	682,794	1,293,740	479,331	-	479,331	1,773,071
Contracting capacity resources	-	-	-	-	986,500	-	986,500	986,500
Conferences, conventions, meetings	-	160,640	3,736	164,376	-	429,754	429,754	594,130
Travel	11,933	67,883	10,553	90,369	68,298	116,665	184,963	275,332
Legal fees	47,715	-	47,715	95,430	138,562	-	138,562	233,992
Employee benefits/payroll taxes	12,350	14,693	9,763	36,806	114,824	-	114,824	151,630
Rent, parking, other occupancy	-	-	-	-	145,082	-	145,082	145,082
Advertising	77,980	-	-	77,980	-	-	-	77,980
Focus groups	62,649	-	-	62,649	-	-	-	62,649
Accounting fees	-	-	-	-	55,705	-	55,705	55,705
Information technology	-	-	-	-	33,559	-	33,559	33,559
Insurance – non-employee related	-	-	-	-	14,725	833	15,558	15,558
Interim researchers	-	15,475	-	15,475	-	-	-	15,475
Equipment rental & maintenance	-	-	-	-	15,274	-	15,274	15,274
Telephone & telecommunications	1,587	1,720	1,199	4,506	5,956	4,375	10,331	14,837
Supplies	19	-	-	19	13,547	929	14,476	14,495
Books, subscriptions, references	3,850	67	87	4,004	5,591	-	5,591	9,595
Other expenses	-	-	-	-	5,164	-	5,164	5,164
Printing & copying	314	-	-	314	3,848	799	4,647	4,961
Bank/payroll fees	-	-	-	-	2,031	-	2,031	2,031
Postage & shipping	77	-	-	77	764	512	1,276	1,353
	<u>\$ 1,848,077</u>	<u>\$ 1,410,127</u>	<u>\$ 1,180,910</u>	<u>\$ 4,439,114</u>	<u>\$ 3,166,048</u>	<u>\$ 1,006,745</u>	<u>\$ 4,172,793</u>	<u>\$ 8,611,907</u>

The accompanying footnotes are an integral part of these statements.

Patient-Centered Outcomes Research Institute

Statement of Functional Expenses

For the Period from November 10, 2010 (Inception) through December 31, 2010

	Program Services				Supporting Services			Total
	Communications, Outreach, and Engagement	Methodology	Research	Total Program Services	Administrative – General	Administrative – Board	Total Supporting Services	
Directors' compensation	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 78,049	\$ 78,049	\$ 78,049
Other professional services	-	-	-	-	72,928	-	72,928	72,928
Management fees	-	-	-	-	183,892	-	183,892	183,892
Conferences, conventions, meetings	-	-	-	-	19,486	409	19,895	19,895
Travel	-	-	-	-	10,617	516	11,133	11,133
Legal fees	-	-	-	-	71,624	-	71,624	71,624
Focus groups	420	-	-	420	-	-	-	420
Accounting fees	-	-	-	-	11,750	-	11,750	11,750
Information technology	200	-	-	200	-	-	-	200
Telephone & telecommunications	-	-	-	-	240	-	240	240
Supplies	-	-	-	-	69	31	100	100
Bank/payroll fees	-	-	-	-	33	-	33	33
Mailing services	-	-	-	-	-	250	250	250
	<u>\$ 620</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 620</u>	<u>\$ 370,639</u>	<u>\$ 79,255</u>	<u>\$ 449,894</u>	<u>\$ 450,514</u>

The accompanying footnotes are an integral part of these statements.

Patient-Centered Outcomes Research Institute

Notes to Financial Statements

Note 1. Nature of Activities and Significant Accounting Policies

The Patient-Centered Outcomes Research Institute (PCORI) was established by federal law (42 U.S.C. 1301 et. seq.) and incorporated in November 2010 to conduct research to provide information about the best available evidence to help patients and their health care providers make more informed decisions. PCORI's research is intended to give patients a better understanding of the prevention, treatment, and care options available and the science that supports those options.

PCORI is unique both in its mission and how it seeks to fulfill it. PCORI helps people make informed health care decisions – and improves health care delivery and outcomes – by producing and promoting high integrity, evidence-based information that comes from research guided by patients, caregivers, and the broader health care community.

PCORI is a non-profit corporation, governed by a 21-member Board of Governors, including the Director of the Agency for Healthcare Research and Quality (AHRQ), the Director of the National Institutes of Health (NIH), and 19 members appointed by the Comptroller General of the United States. By law, the Comptroller must appoint three members representing patients and healthcare consumers, seven members representing physicians and providers, three members representing private payers, three members representing pharmaceutical, device, and diagnostic manufacturers or developers, one member representing quality improvement or independent health services researchers, and two members representing the federal government or the states (including at least one member representing a federal health program or agency).

In accordance with the enabling legislation, Congress has established the Patient-Centered Outcomes Research Trust Fund (PCORTF). The PCORTF received funding by a Congressional appropriation through 2019. Beginning in FY 2011, 20% of the amount funded is transferred in accordance with the enabling legislation to AHRQ and the Department of Health and Human Services (HHS). The remaining balance plus accrued interest represents the appropriations to PCORI. PCORI appropriations were \$120,000,000 and \$50,000,000 for fiscal years 2011 and 2010, respectively (See Note 2).

A summary of PCORI's significant accounting policies follows:

Basis of accounting: The accompanying financial statements are presented in accordance with the accrual basis of accounting, whereby, revenue is recognized when earned and expenses are recognized when incurred.

Basis of presentation: PCORI follows the accounting requirements of Financial Accounting Standards Board (FASB) Account Standards Codification (the Codification). As required by the Non-Profit Entities Topic of the Codification, PCORI is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted, temporarily restricted, and permanently restricted. PCORI had no temporarily restricted or permanently restricted net assets at December 31, 2011 and 2010.

Property and equipment: Purchases of property and equipment are recorded at cost and depreciated using the straight-line method over their estimated useful life. It is the policy of PCORI to capitalize property and equipment purchases greater than \$500. Property and equipment at December 31, 2011, consisted of construction-in-process for tenant improvements. PCORI will amortize these costs over the term of PCORI's lease, which begins in fiscal year 2012.

Patient-Centered Outcomes Research Institute

Notes to Financial Statements

Note 1. Nature of Activities and Significant Accounting Policies (Continued)

Valuation of long-lived assets: Long-lived assets and certain identifiable intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of long-lived assets is measured by a comparison of the carrying amount of the assets to future undiscounted net cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. Assets to be disposed of are reportable at the lower of the carrying amount or fair value, less costs to sell. At December 31, 2011 and 2010, management did not consider the value of any property or equipment to be impaired.

Revenue recognition: The PCORTF received its funding for 2010 through 2019 through an appropriation from Congress at the time of establishment. Federal appropriations are deemed to be earned and are recorded as revenue in the period designated by Congress. The government fiscal year ends on September 30.

Research awards: PCORI uses contracts as its only means of procurement for program services. Expenses are recorded at the time of the event, when the deliverable has been met or the cost has been incurred.

Tax status: PCORI, a non-profit organization incorporated in the District of Columbia and formed under the Patient Protection and Affordable Care Act, is exempt from income taxes under Section 501(c)(1) of the Internal Revenue Code (IRC). PCORI did not receive any revenue from any sources besides the PCORTF, and consequently, PCORI did not incur a federal or state income tax liability in 2011 or 2010.

PCORI follows the accounting standard on accounting for uncertainty in income taxes, which addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under this guidance, PCORI may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by taxing authorities based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The guidance on accounting for uncertainty in income taxes also addresses de-recognition, classification, interest and penalties on income taxes, and accounting in interim periods. Management evaluated PCORI's tax positions and concluded that PCORI has not taken any uncertain tax positions that require adjustment to the financial statements to comply with the provisions of this guidance.

Functional allocation of expenses: The costs of providing various programs and activities have been summarized on a functional basis in the statements of activities. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Financial and credit risk: PCORTF was funded through Congressional appropriation in 2010, for the years 2010 through 2019. PCORI is the only organization that has the authority to draw from the PCORTF.

Patient-Centered Outcomes Research Institute

Notes to Financial Statements

Note 1. Nature of Activities and Significant Accounting Policies (Continued)

Use of estimates: The preparation of financial statements requires management to make estimates and assumptions in conformity with generally accepted accounting principles 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.

Subsequent events: PCORI evaluated subsequent events through April 20, 2012, which is the date the financial statements were available to be issued.

Note 2. Amounts Held by PCOR Trust Fund

Amounts held by PCOR Trust Fund at December 31, 2011 and 2010, are as follows:

	2011	2010
Beginning balance	\$ 49,638,865	\$ -
Federal appropriations:		-
Government Fiscal Year 2010 Appropriation	-	10,000,000
Government Fiscal Year 2011 Appropriation	-	50,000,000
Less AHRQ and HHS share 20% of appropriation as mandated by statute	-	(10,001,322)
Government Fiscal Year 2012 Appropriation	150,000,000	-
Less AHRQ and HHS share 20% of appropriation as mandated by statute	(30,000,000)	-
Interest earned	24,106	10,187
Less draws by PCORI	(11,584,000)	(370,000)
	<u>\$ 158,078,971</u>	<u>\$ 49,638,865</u>

PCORI receives its funding through appropriations from Congress. As such, the appropriations are subject to financial and compliance audits by the Government Accountability Office.

Note 3. Property and Equipment

Property and equipment and accumulated depreciation at December 31, 2011 and 2010, are as follows:

	2011	2010
Leasehold improvements	\$ 159,153	\$ -
Less accumulated depreciation	-	-
	<u>\$ 159,153</u>	<u>\$ -</u>

PCORI had no depreciation or amortization expense for the years ended December 31, 2011 or 2010. Leasehold improvements will be amortized over the life of the lease.

In December 2011, PCORI entered into an agreement with a construction company for the construction of its headquarters. The total value of the contract is \$1,015,076. PCORI has paid the construction company \$99,275 for the year ended December 31, 2011.

Patient-Centered Outcomes Research Institute

Notes to Financial Statements

Note 4. Leases

During 2011, PCORI entered into a non-cancelable operating lease for office space in Washington, D.C., expiring on October 31, 2019.

Future minimum rental payments applicable to the lease at December 31, 2011, are as follows:

Years Ending December 31,

2012	\$	648,814
2013		665,034
2014		681,658
2015		698,684
2016		716,113
2017 and thereafter		2,061,092
	\$	<u>5,471,395</u>

Note 5. Financial Risks and Uncertainties

The PCORTF was funded by appropriation of the U.S. Government through September 30, 2019. The potential for future changes to the enabling legislation exist, but the impact on the organization or the availability of funding is unknown at this time.



**Independent Auditor's Report on Internal Control over Financial Reporting
and on Compliance and Other Matters Based on an Audit of Financial
Statements Performed in Accordance With *Government Auditing Standards***

To the Audit Committee
Patient-Centered Outcomes Research Institute
Washington, D.C.

We have audited the financial statements of Patient-Centered Outcomes Research Institute (PCORI) as of and for the year ended December 31, 2011, and have issued our report thereon dated April 20, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

Management of PCORI is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered PCORI's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of PCORI's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of PCORI's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We consider the following deficiency in internal control over financial reporting to be a material weakness, as defined above:

Finding 2011-01: Financial Reporting

Questioned Costs: None

Condition and Context: Federal appropriations are deemed to be earned and are recorded as revenue in the period appropriated by Congress. PCORI operates on a calendar fiscal year, while the appropriations from the federal government are made in accordance with the September 30 fiscal year of the government. PCORI recorded adjusting journal entries for fiscal years 2011 and 2010, to properly recognize the appropriation from the federal government as revenue and receivable from the PCOR Trust Fund, as well as the related investment earnings for those periods.

Cause: The timing difference between the two fiscal year-ends gave rise to the required adjustment.

Effect: The effect of the entries is to recognize \$40,000,000 and \$120,000,000 of revenue and related receivable from the PCOR Trust Fund for 2010 and 2011, respectively.

Recommendation: We recommend that management recognize revenue in accordance with the enabling legislation, and as such, revenue is recognized in the government fiscal year for which it was appropriated.

Views of Responsible Officials and Planned Corrective Actions: PCORI management agrees with this finding and has made all appropriate entries in the underlying financial statements and the revenue recognition protocol for future periods.

There has never been any confusion or disagreement regarding the nature of the PCOR Trust Fund (PCORTF) or the amount of funds contained in it; however, given the unique nature of PCORI, there has been some uncertainty regarding the timing of funding that is received by the PCORTF prior to the PCORI fiscal year and when these funds should be reflected in the PCORI financial statements.

In developing its accounting procedures, PCORI sought advice and counsel from legal, financial, and government accounting subject matter experts, and various government organizations with oversight and rule-making responsibilities. Based on this input, PCORI established a revenue recognition methodology that was challenged under audit, and PCORI agreed to make the requested change.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether PCORI's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

PCORI's response to the finding identified in our audit is described in the finding noted above. We did not audit PCORI's response, and accordingly, we express no opinion on the response.

This report is intended solely for the information and use of the Audit Committee and management and is not intended to be and should not be used by anyone other than those specified parties.

McGladrey & Pullen, LLP

Vienna, Virginia
April 20, 2012