

Patient-Centered Outcomes Research Institute

Financial Report
September 30, 2016

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Patient-Centered Outcomes Research Institute

Management's Discussion and Analysis

About Patient-Centered Outcomes Research Institute (PCORI)

The Patient-Centered Outcomes Research Institute was authorized in 2010 by the Patient Protection and Affordable Care Act (42 U.S.C. 1301 et seq.) (Act) to “assist patients, clinicians, purchasers, and policy-makers in making informed health decisions by advancing the quality and relevance of evidence concerning the manner in which diseases, disorders, and other health conditions can effectively and appropriately be prevented, diagnosed, treated, monitored, and managed through research and evidence synthesis.” It does this by supporting comparative clinical effectiveness research (CER) projects designed to answer questions most important to patients. PCORI is also charged with disseminating the results of that research, focusing on “health outcomes, clinical effectiveness, and appropriateness of the medical treatments, services, and items” studied.

PCORI is a 501(c)(1) tax-exempt, nonprofit corporation, governed by a 21-member multi-stakeholder Board of Governors, including 19 members appointed by the Comptroller General of the United States. By law, the Comptroller General 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). The Act also provides that the Directors of the Agency for Healthcare Research and Quality (AHRQ) and the National Institutes of Health (NIH), or their designees, be members of the Board.

In addition to its Board, PCORI's work is guided by a Methodology Committee composed of up to 17 members, who are charged with developing and advancing the science and methodologies of CER. Members of the Methodology Committee, also appointed by the Comptroller General, are experts in their fields of endeavor, including but not limited to health services research, clinical research, CER, biostatistics, genomics and research methodologies.

PCORI's Board is guided by five committees with specific areas of focus: Engagement, Dissemination, and Implementation; the Research Transformation; Science Oversight; Finance and Administration; and Governance. The Governance Committee also serves to fill as the Audit Committee role.

Financial Highlights

In fiscal year ended September 30, 2010, \$1.26 billion was appropriated for the Patient-Centered Outcome Research Trust Fund (PCORTF): \$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 (FASB). 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.

Patient-Centered Outcomes Research Institute

Management's Discussion and Analysis

The following table highlights key components of PCORI's financial statements during FY 2016:

Financial Data	FY 2016	FY 2015	Increase/ (Decrease)	Percentage Difference
Statement of Financial Position:				
Assets	\$ 939,426,395	\$ 835,237,427	\$ 104,188,968	12%
Liabilities	64,490,094	87,475,850	(22,985,756)	-26%
Net assets	<u>\$ 874,936,301</u>	<u>\$ 747,761,577</u>	<u>\$ 127,174,724</u>	<u>17%</u>
Statement of Activities:				
Revenue and support	\$ 472,719,041	\$ 423,066,941	\$ 49,652,100	12%
Expenses	345,544,317	276,958,845	68,585,472	25%
Change in net assets	<u>\$ 127,174,724</u>	<u>\$ 146,108,096</u>	<u>\$ (18,933,372)</u>	<u>-13%</u>

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 of PCORI's operations. Readers are encouraged to gain a deeper understanding by reviewing PCORI's financial statements and the notes to the accompanying financial statements.

Statements of Financial Position: As disclosed in the accompanying Statements of Financial Position and summarized in the table above, PCORI's net assets at September 30, 2016, were \$874.9 million. Specifically, PCORI's total assets of \$939.4 million included \$916.5 million of funds held in trust and \$12.6 million in cash. Total liabilities of \$64.5 million represent accounts payable, accrued expenses and deferred rent.

Statements of Activities: In fiscal year 2016, revenue and support totaled \$472.7 million, of which \$120 million came from appropriations, \$98.7 million from the Federal Hospital Insurance (FHI) and Federal Supplementary Medical Insurance (FSMI) Trust Funds, and \$252.3 million from PCOR fees and \$1.7 million from interest earned on the PCORTF investment portfolio.

For the fiscal year ended September 30, 2016, the revenue of \$472.7 million includes estimated PCOR fees deposited into the PCORTF less an allowance for doubtful collection. Management is in possession of certain federal agency-generated estimates that could be used for estimating the total realizable fiscal year 2016 PCOR fee net revenue on an accrual basis; however, accounting standards dictate that estimates should be based on historical experience and other assumptions that are considered reasonable under given circumstances. Management is of the opinion that, given the complexity of the fee calculations, without historical perspective, estimates cannot be consistently estimated. To that end, PCOR fee revenue is recognized as revenue as it is received less an allowance until such a time as there is more historical perspective on which to evaluate the reliability of the estimates.

Expense levels increased between FY 2016 and FY 2015. The increase from \$277 million to \$345.5 million is driven primarily by the growing research portfolio; \$277.2 million was spent on extramural and internal research projects that have a life cycle ranging from three to five years.

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 attention of the Finance Department, Patient-Centered Outcomes Research Institute, 1828 L Street, NW, Suite 900, Washington, D.C., 20036, or Finance@pcori.org. Additional information regarding PCORI's operations can be found at www.pcori.org.

Independent Auditor's Report

To the Governance Committee of the Board of Governors
Patient-Centered Outcomes Research Institute
Washington, D.C.

Report on the Financial Statements

We have audited the accompanying financial statements of Patient-Centered Outcomes Research Institute (PCORI), which comprise the statements of financial position as of September 30, 2016 and 2015, the related statements of activities, cash flows and functional expenses for years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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 financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of PCORI as of September 30, 2016 and 2015, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our reports dated March 2, 2017, and February 23, 2016, 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 those reports 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 internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* in considering PCORI's internal control over financial reporting and compliance.

RSM US LLP

Washington, D.C.
March 2, 2017

Patient-Centered Outcomes Research Institute

**Statements of Financial Position
September 30, 2016 and 2015**

	2016	2015
Assets		
Cash	\$ 12,562,788	\$ 18,672,456
Amounts held by PCOR Trust Fund (Note 2)	916,536,536	797,867,495
Prepaid expenses	1,127,620	10,221,960
Deposits and other assets	869,120	919,636
Property and equipment, net (Note 3)	8,330,331	7,555,880
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Total assets	\$ 939,426,395	\$ 835,237,427
Liabilities and Net Assets		
Liabilities:		
Accounts payable and accrued expenses	\$ 63,031,677	\$ 85,817,617
Deferred rent and tenant improvement allowance	1,458,417	1,658,233
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Total liabilities	64,490,094	87,475,850
Commitments and contingencies (Notes 4, 5, 6, 7 and 8)		
Net assets:		
Unrestricted	874,936,301	747,761,577
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Total liabilities and net assets	\$ 939,426,395	\$ 835,237,427

See notes to financial statements.

Patient-Centered Outcomes Research Institute

Statements of Activities

Years Ended September 30, 2016 and 2015

	2016	2015
Revenue and support (Note 2):		
Federal appropriations	\$ 120,000,000	\$ 120,000,000
Patient-Centered Outcomes Research Fee	252,310,690	210,045,090
Transfers from the Federal Hospital Insurance (FHI) and the Federal Supplementary Medical Insurance (FSMI) Trust Funds	98,698,400	92,848,000
Interest income	1,709,951	173,851
Total revenue and support	472,719,041	423,066,941
Expenses:		
Program services:		
Research awards	277,157,514	214,304,095
Methodology	632,722	643,705
Contract management	5,784,933	6,150,238
Communications, outreach and engagement	9,091,015	8,445,443
Science	24,830,964	23,497,283
	317,497,148	253,040,764
Supporting services:		
Administrative – general	27,097,489	22,851,833
Administrative – board	949,680	1,066,248
	28,047,169	23,918,081
Total expenses	345,544,317	276,958,845
Change in net assets	127,174,724	146,108,096
Net assets:		
Beginning	747,761,577	601,653,481
Ending	\$ 874,936,301	\$ 747,761,577

See notes to financial statements.

Patient-Centered Outcomes Research Institute

Statements of Cash Flows
Years Ended September 30, 2016 and 2015

	2016	2015
Cash flows from operating activities:		
Change in net assets	\$ 127,174,724	\$ 146,108,096
Adjustments to reconcile change in net assets to net cash (used in) provided by operating activities:		
Depreciation and amortization	3,598,355	3,640,162
Deferred rent	(199,816)	(141,731)
Loss on disposal of property and equipment	-	224,985
Changes in assets and liabilities:		
(Increase) decrease in:		
Amounts held by PCOR Trust Fund	(118,669,041)	(178,866,942)
Prepaid expenses	9,094,340	2,836,229
Deposits and other assets	50,516	392,268
(Decrease) increase in:		
Accounts payable and accrued expenses	(22,785,940)	42,508,431
Net cash (used in) provided by operating activities	(1,736,862)	16,701,498
Cash flows from investing activities:		
Purchases of property and equipment	(4,372,806)	(5,463,226)
Net cash used in investing activities	(4,372,806)	(5,463,226)
Net (decrease) increase in cash	(6,109,668)	11,238,272
Cash:		
Beginning	18,672,456	7,434,184
Ending	\$ 12,562,788	\$ 18,672,456

See notes to financial statements.

Patient-Centered Outcomes Research Institute

Statement of Functional Expenses Year Ended September 30, 2016

	Program Services					Supporting Services			Total	
	Research awards	Methodology	Contract Management	Communications, Outreach, and Engagement	Science	Total Program Services	Administrative – Board	Administrative – General		Total Supporting Services
Research awards	\$ 277,157,514	\$ -	\$ -	\$ -	\$ -	\$ 277,157,514	\$ -	\$ -	\$ -	\$ 277,157,514
Salaries and wages – other	-	-	2,071,268	3,793,625	12,741,766	18,606,659	-	6,034,498	6,034,498	24,641,157
Other professional services	-	380,463	916,855	2,888,479	5,967,682	10,153,479	197,090	7,656,236	7,853,326	18,006,805
Employee benefits/payroll taxes	-	-	183,366	338,744	1,131,004	1,653,114	-	4,631,480	4,631,480	6,284,594
Depreciation and amortization	-	-	302,282	554,032	1,859,942	2,716,256	-	882,099	882,099	3,598,355
Travel	-	34,660	449,740	514,992	821,536	1,820,928	125,098	544,703	669,801	2,490,729
Rent, parking, other occupancy	-	2,684	211,340	367,561	1,250,021	1,831,606	19,232	786,272	805,504	2,637,110
Temporary help	-	-	426,237	109,417	135,448	671,102	-	1,304,632	1,304,632	1,975,734
Conferences, conventions, meetings	-	15,824	806,879	337,569	636,861	1,797,133	80,558	766,538	847,096	2,644,229
Legal fees	-	-	-	-	-	-	-	689,678	689,678	689,678
Reviewer services	-	-	374,600	25,300	155,870	555,770	-	-	-	555,770
Accounting fees	-	-	-	-	-	-	-	104,917	104,917	104,917
Board/committee compensation	-	196,803	-	-	-	196,803	468,520	-	468,520	665,323
Telephone and communications	-	2,242	38,934	34,724	46,595	122,495	57,664	365,484	423,148	545,643
Supplies	-	-	53	1,500	316	1,869	23	162,364	162,387	164,256
Information technology	-	-	-	3,051	17,640	20,691	771	2,262,594	2,263,365	2,284,056
Other expenses	-	-	-	8,499	1,802	10,301	426	228,451	228,877	239,178
Insurance – non-employee related	-	-	-	-	-	-	-	301,226	301,226	301,226
Equipment rental and maintenance	-	-	-	-	-	-	-	219,461	219,461	219,461
Books, subscriptions, references	-	-	1,155	109,663	60,548	171,366	250	106,516	106,766	278,132
Bank/payroll fees	-	-	-	3	-	3	6	4,751	4,757	4,760
Postage and shipping	-	46	2,224	3,856	3,933	10,059	42	45,589	45,631	55,690
	\$ 277,157,514	\$ 632,722	\$ 5,784,933	\$ 9,091,015	\$ 24,830,964	\$ 317,497,148	\$ 949,680	\$ 27,097,489	\$ 28,047,169	\$ 345,544,317

See notes to financial statements.

Patient-Centered Outcomes Research Institute

Statement of Functional Expenses Year Ended September 30, 2015

	Program Services					Supporting Services			Total	Total
	Research awards	Methodology	Contract Management	Communications, Outreach, and Engagement	Science	Total Program Services	Administrative – Board	Administrative – General		
Research awards	\$ 214,304,095	\$ -	\$ 30,222	\$ -	\$ -	\$ 214,334,317	\$ -	\$ -	\$ -	\$ 214,334,317
Salaries and wages – other	-	-	1,722,908	3,425,510	10,437,432	15,585,850	-	5,104,196	5,104,196	20,690,046
Other professional services	-	308,229	1,616,849	2,816,955	7,059,478	11,801,511	319,456	5,160,254	5,479,710	17,281,221
Employee benefits/payroll taxes	-	-	173,290	344,884	1,050,465	1,568,639	119	4,114,855	4,114,974	5,683,613
Depreciation and amortization	-	-	303,318	603,308	1,837,507	2,744,133	-	896,029	896,029	3,640,162
Travel	-	21,965	827,766	558,213	963,677	2,371,621	179,129	925,635	1,104,764	3,476,385
Rent, parking, other occupancy	-	-	191,537	380,974	1,160,338	1,732,849	-	565,819	565,819	2,298,668
Temporary help	-	-	387,308	-	27,300	414,608	-	1,083,526	1,083,526	1,498,134
Conferences, conventions, meetings	-	123,898	347,108	168,615	286,832	926,453	121,800	246,813	368,613	1,295,066
Legal fees	-	-	-	4,569	303,692	308,261	-	517,622	517,622	825,883
Reviewer services	-	200	464,291	1,670	225,800	691,961	-	-	-	691,961
Accounting fees	-	-	-	-	-	-	-	621,027	621,027	621,027
Board/committee compensation	-	189,045	7,935	-	-	196,980	406,186	-	406,186	603,166
Telephone and communications	-	-	50,008	42,244	25,814	118,066	38,073	299,731	337,804	455,870
Supplies	-	-	9,201	1,355	1,284	11,840	55	326,955	327,010	338,850
Information technology	-	-	52	2,939	19,222	22,213	-	2,113,859	2,113,859	2,136,072
Other expenses	-	-	5,298	25,812	66,771	97,881	-	227,289	227,289	325,170
Insurance – non-employee related	-	-	-	-	-	-	-	248,669	248,669	248,669
Equipment rental and maintenance	-	-	273	58	-	331	-	220,248	220,248	220,579
Books, subscriptions, references	-	-	6,654	30,440	29,355	66,449	-	80,556	80,556	147,005
Advertising	-	-	-	35,000	-	35,000	-	29,325	29,325	64,325
Printing and copying	-	-	4,987	1,721	675	7,383	1,189	27,570	28,759	36,142
Bank/payroll fees	-	-	15	13	2	30	-	31,323	31,323	31,353
Postage and shipping	-	368	1,218	1,163	1,639	4,388	241	10,532	10,773	15,161
	<u>\$ 214,304,095</u>	<u>\$ 643,705</u>	<u>\$ 6,150,238</u>	<u>\$ 8,445,443</u>	<u>\$ 23,497,283</u>	<u>\$ 253,040,764</u>	<u>\$ 1,066,248</u>	<u>\$ 22,851,833</u>	<u>\$ 23,918,081</u>	<u>\$ 276,958,845</u>

Patient-Centered Outcomes Research Institute

Notes to Financial Statements

Note 1. Nature of Activities and Significant Accounting Policies

Nature of activities: The Patient-Centered Outcomes Research Institute (PCORI) was authorized in 2010 by the Patient Protection and Affordable Care Act (42 U.S.C. 1301 et seq.) (Act) to “assist patients, clinicians, purchasers, and policy-makers in making informed health decisions by advancing the quality and relevance of evidence concerning the manner in which diseases, disorders, and other health conditions can effectively and appropriately be prevented, diagnosed, treated, monitored, and managed through research and evidence synthesis.” It does this by supporting comparative clinical effectiveness research (CER) projects designed to answer questions most important to patients. PCORI also is charged with disseminating the results of that research, focusing on “health outcomes, clinical effectiveness, and appropriateness of the medical treatments, services, and items” studied.

PCORI is a 501(c)(1) nonprofit corporation, governed by a 21-member multistakeholder Board of Governors (the Board), including 19 members appointed by the Comptroller General of the United States. By law, the Comptroller General 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). The Act also provides that the Directors of the Agency for Healthcare Research and Quality (AHRQ) and the National Institutes of Health (NIH), or their designees, be members of the Board.

In accordance with the enabling legislation, Congress established the Patient-Centered Outcomes Research Trust Fund (PCORTF). In the fiscal year ended September 30, 2010, \$1.26 billion was appropriated for the PCORTF; this funding is available through September 30, 2019, without further appropriation. Annual appropriations are deposited in November into the PCORTF as follows: \$10 million in fiscal year 2010, \$50 million in fiscal year 2011 and \$150 million a year in each of the eight-fiscal years, 2012 through 2019. These amounts, less the annual 20% distribution to AHRQ and HHS beginning in fiscal year 2011, plus interest income, are available to PCORI as needed.

The Secretary of the Treasury (the Secretary) also provides for transfers to the PCORTF from the Federal Hospital Insurance (FHI) Trust Fund and the Federal Supplementary Medical Insurance (FSMI) Trust Fund in proportion to the total expenditures during such fiscal year that are made under Social Security Act Title XVIII: Health Insurance for the Aged from the respective trust fund. In calendar year 2012, the PCORTF received an amount equal to \$1 multiplied by the average number of individuals entitled to benefits under part A or enrolled under part B of title XVIII during the year ended September 30, 2013. For each fiscal year ending September 30 thereafter, 2014 through 2019, the PCORTF will receive an amount equal to \$2 multiplied by the average number of individuals entitled to benefits under part A, or part B, of title XVIII during such fiscal year. For fiscal years beginning after September 30, 2014, these amounts will be adjusted for increases in healthcare spending. The increase will be the product of the sum of such dollar amount for the previous fiscal year plus an amount equal to the product of such dollar amount for the previous fiscal year, multiplied by the percentage increase in the projected per capita of National Health Expenditures, as most recently published by the Secretary before the beginning of the fiscal year.

In the year ended September 30, 2013, the PCORTF began receiving the funding from the fees that will be imposed on certain health insurance and self-insured health plans. The fees will also be adjusted for increases in healthcare spending. The increase is a product of the sum of such dollar amount for the previous fiscal year plus an amount equal to the product of such dollar amount for the previous fiscal year, multiplied by the percentage increase in the projected per capital of National Health Expenditures as most recently published by the Secretary before the beginning of the fiscal year.

Patient-Centered Outcomes Research Institute

Notes to Financial Statements

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

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 Not-for-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, as applicable. PCORI had no temporarily restricted or permanently restricted net assets at September 30, 2016 and 2015.

Property and equipment: Property and equipment at September 30, 2016 and 2015, consisted of leasehold improvements, software, furniture, fixtures and equipment. Purchases of property and equipment are recorded at cost and depreciated using the straight-line method over their estimated useful lives of four to eight years. It is the policy of PCORI to capitalize property and equipment purchases greater than \$5,000. PCORI amortizes leasehold improvement costs over the remaining term of PCORI's lease, or the useful life of the improvement, whichever is shorter.

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 retired are reportable at the lower of the carrying amount or fair value, less disposal costs.

Deferred rent: PCORI has various lease agreements for rental spaces in Washington, D.C. Under the terms of certain lease agreements, PCORI occupied office space for one to four months of free rent. The free month's rent and escalating annual rent increases, in addition to a tenant improvement allowance, are being recognized on a straight-line basis over the life of the lease agreement and are reflected as deferred rent in the accompanying statements of financial position.

Revenue recognition: Congress appropriated \$1.26 billion for the PCORTF at the time of establishment. These federal appropriations are deemed to be earned and are recognized as revenue in the periods designated by Congress. The Act explicitly identified specific amounts and a period of attribution by fiscal year, beginning in October 2010 and ending in September 2019.

In accordance with the legislation, beginning in fiscal year 2012, the Secretary of the Treasury provided for transfer to the PCORTF from the FHI Trust Fund and the FSMI Trust Fund in proportion to the total expenditures during such fiscal year that were made under title XVIII from the respective trust fund. The transfer amounts are provided by the Center for Medicare and Medicaid Services (CMS) Budget and they are updated annually based on the published Mid-Session Review of the President's Budget. The estimated transfers are subject to a true-up when the final calculations become available. The transfers are deemed to be earned and are recognized as revenue on a cash basis in the period received or adjusted.

Patient-Centered Outcomes Research Institute

Notes to Financial Statements

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

Patient-Centered Outcomes Research (PCOR) fee revenue received is based on federal agency-generated estimates which are true-up the following year based on Internal Revenue Service (IRS) reconciliation of actual PCOR fee collections. Accounting standards dictate that estimates should be based on historical experience and other assumptions that are considered reasonable under given circumstances. Management is in possession of certain federal agency-generated estimates that could be used for estimating the total realizable fiscal year PCOR fee. In prior years, the PCOR fees were budgeted at 10% under the government projections for planning purposes to guard against overcommitting resources in the event actual revenue is much lower than the projection.

Research awards: PCORI uses contracts as its only means of procurement for program services. Expenses are recorded at the time the deliverable has been met, or when the cost has been incurred. As of September 30, 2016 and 2015, research awards totaling approximately \$1.55 billion and \$1.18 billion have been entered into, respectively. Prepayments on awards totaling \$0 and \$9,338,358 are included in prepaid expenses in the statements of financial position at September 30, 2016 and 2015, respectively.

Tax status: PCORI, a nonprofit organization incorporated in the District of Columbia and authorized by the Patient Protection and Affordable Care Act, is exempt from income taxes under Section 501(c)(1) of the Internal Revenue Code (IRC) and the applicable income tax regulations of the District of Columbia, except to the extent that unrelated business income is generated. No provision for income taxes was required for the years ended September 30, 2016 and 2015, as PCORI has no unrelated business income revenue.

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: The PCORTF was funded through congressional appropriation in fiscal year 2010 for the fiscal years 2010 through 2019. PCORI, HHS and AHRQ are the only organizations that have access to the assets of the PCORTF.

Use of estimates: The preparation of financial statements requires management to make estimates and assumptions in conformity with generally accepted accounting principles in the United States of America (GAAP) 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.

Patient-Centered Outcomes Research Institute

Notes to Financial Statements

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

Audit requirements: PCORI is subject to financial and governmental oversight in accordance with its enabling legislation. PCORI is required to provide for the conduct of an annual financial audit through a private entity with experience in conducting financial audits. The Comptroller General of the United States is required to review the financial audit annually; the processes established by PCORI not less frequently than every five years; the dissemination/training activities and the data networks of PCORI not less frequently than every five years; the overall effectiveness of activities and the dissemination, training, and capacity-building activities conducted by PCORI not less frequently than every five years; and the adequacy and use of the funding for PCORI and the activities conducted no later than eight years after the date of enactment.

Recent accounting pronouncements: In May 2014, the FASB issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which establishes a comprehensive revenue recognition standard for virtually all industries in GAAP, including those that previously followed industry-specific guidance. For non-public entities, the new standard was effective for annual periods beginning after December 15, 2017. In August 2015, the FASB issued ASU 2015-14, which defers the effective date of Update 2014-09 for all entities by one year. The adoption of the new standard is not anticipated to have a material effect on PCORI's financial condition or changes in net assets.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. The guidance in this ASU supersedes the leasing guidance in Topic 840, *Leases*. Under the new guidance, lessees are required to recognize lease assets and lease liabilities on the statement of financial position for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the statements of activities. The new standard is effective for PCORI for the fiscal year beginning October 1, 2020. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. PCORI is currently evaluating the impact of the pending adoption of the new standard on the financial statements.

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. The amendments in this ASU make improvements to the information provided in financial statements and accompanying notes of not-for-profit entities. The amendments set forth the FASB's improvements to net asset classification requirements and the information presented about a not-for-profit entity's liquidity, financial performance, and cash flows. The ASU will be effective for fiscal years beginning after December 15, 2017. Early adoption is permitted. The changes in this ASU should generally be applied on a retrospective basis in the year that the ASU is first applied. PCORI has not yet evaluated the impact of this ASU on the financial statements.

Subsequent events: PCORI evaluated subsequent events through March 2, 2017, which is the date the financial statements were available to be issued.

Patient-Centered Outcomes Research Institute

Notes to Financial Statements

Note 2. Amounts Held by PCOR Trust Fund

Amounts held by PCORTF available to PCORI at September 30, 2016 and 2015, and activity in the Trust Fund for the years then ended, are as follows:

	2016	2015
Beginning balance	\$ 797,867,495	\$ 619,000,553
Federal appropriations:		
Government fiscal year appropriation	150,000,000	150,000,000
Less AHRQ and HHS share 20% of appropriation as mandated by statute	(30,000,000)	(30,000,000)
Transfers from FSMI, October	72,994,000	61,506,000
Less AHRQ and HHS share 20% of appropriation as mandated by statute	(14,598,800)	(12,301,199)
Transfers from FHI, October	50,379,000	54,554,000
Less AHRQ and HHS share 20% of appropriation as mandated by statute	(10,075,800)	(10,910,800)
Patient-Centered Outcomes Research Fee	315,388,362	262,556,362
Less AHRQ and HHS share 20% of appropriation as mandated by statute	(63,077,672)	(52,511,272)
Interest earned	1,709,951	173,851
Draws by PCORI	(354,050,000)	(244,200,000)
	<u>\$ 916,536,536</u>	<u>\$ 797,867,495</u>

Amounts held by PCORTF are placed in market-based overnight Treasury securities. These are Treasury securities whose interest rates or prices are determined based on the interest rates or prices of Treasury-related financial instruments issued or trading in the market, rather than on the interest rates or prices of outstanding marketable Treasury securities. This type of security is bought and redeemed at par, and pays interest on maturity. The fair market value of this type of security is par.

Note 3. Property and Equipment

Property and equipment and accumulated depreciation at September 30, 2016 and 2015, are as follows:

	2016	2015
Leasehold improvements	\$ 6,445,835	\$ 5,727,908
Software development	7,949,462	4,531,178
Furniture, fixtures and equipment	3,744,877	3,508,282
	<u>18,140,174</u>	<u>13,767,368</u>
Less accumulated depreciation	(9,809,843)	(6,211,488)
	<u>\$ 8,330,331</u>	<u>\$ 7,555,880</u>

Patient-Centered Outcomes Research Institute

Notes to Financial Statements

Note 4. Leases

PCORI has four non-cancelable operating leases for office spaces in Washington, D.C. that expire on December 31, 2018, July 31, 2019 and February 29, 2020 (two leases), respectively.

Future minimum rental payments applicable to the leases at September 30, 2016, are as follows:

Years ending September 30:	
2017	\$ 2,694,708
2018	2,766,640
2019	3,057,108
2020	1,225,381
	<u>\$ 9,743,837</u>

Rent expense for the years ended September 30, 2016 and 2015, was \$2,637,110 and \$2,298,668, respectively.

Note 5. Financial Risks and Uncertainties

On March 1, 2013, the sequestration as required by the Budget Control Act of 2011 (BCA) and pursuant to section 215A of the Balanced Budget and Emergency Deficit Control Act of 1985, as amended (BBEDCA), went into effect. The sequestration imposes a number of percentage-based federal spending reductions, including a reduction in available funding to the PCORTF for obligations. Funds in sequester at September 30, 2016 and 2015, were \$40,575,552 and \$35,873,853, respectively. These funds were released from sequester and made available to the PCORTF for obligations on October 1, 2016 and 2015, respectively.

PCORI maintains cash in bank deposit accounts which, at times, may exceed federally insured limits. PCORI has not experienced any losses in such accounts. PCORI believes it is not exposed to any significant financial risk on cash.

Note 6. Retirement Plan

Effective January 1, 2012, PCORI established the Defined Contribution Retirement Plan of the Patient-Centered Outcomes Research Institute (the Plan). The Plan is intended to be a qualified plan under Section 401(a) of the IRC of 1986, as amended, and it is a governmental plan as described in IRC Section 414(d) and Section 3(32) of the Employee Retirement Income Security Act of 1974 (ERISA), as amended. All full-time regular employees are eligible to participate in the plan on the first day of the month following the date he or she becomes an eligible employee. PCORI matches employees' contributions up to 5% of the participant's eligible compensation. Additionally, PCORI makes a non-elective contribution of 5% of the participant's eligible compensation. Participants are fully vested after one year of continuous employment with PCORI. Contribution expenses totaled \$2,346,763 and \$1,759,336 for the years ended September 30, 2016 and 2015, respectively.

Note 7. Contingencies

PCORI is involved in various claims and disputes arising in the ordinary course of business. The ultimate disposition of these claims and disputes is not expected to have a material adverse effect on PCORI's financial statements.

Patient-Centered Outcomes Research Institute

Notes to Financial Statements

Note 8. Subsequent Events

On September 27, 2016, and December 12, 2016, the Board of PCORI approved research awards totaling \$56.8 million. The contracts for these projects will be executed in FY 2017.

**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 Governance Committee of the Board of Governors
Patient-Centered Outcomes Research Institute
Washington, D.C.

We have audited, in accordance with the 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, the financial statements of Patient-Centered Outcomes Research Institute (PCORI), which comprise the statement of financial position as of September 30, 2016, the related statements of activities, cash flows, and functional expenses for the year then ended and the related notes to the financial statements, and have issued our report thereon dated March 2, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered PCORI's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of PCORI's internal control.

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 a 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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether PCORI's financial statements are free from 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*.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

RSM US LLP

Washington, D.C.
March 2, 2017