

Patient-Centered Outcomes Research Institute

Financial Report
September 30, 2017

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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 2017:

Financial Data	FY 2017	FY 2016	Increase/ (Decrease)	Percentage Difference
Statement of Financial Position:				
Assets	\$ 1,033,061,045	\$ 939,426,395	\$ 93,634,650	10%
Liabilities	92,735,675	64,490,094	28,245,581	44%
Net assets	<u>\$ 940,325,370</u>	<u>\$ 874,936,301</u>	<u>\$ 65,389,069</u>	<u>7%</u>
Statement of Activities:				
Revenue and support	\$ 466,085,422	\$ 472,719,041	\$ (6,633,619)	-1%
Expenses	400,343,278	345,544,317	54,798,961	16%
Unrealized loss	353,075	-	353,075	N/A
Change in net assets	<u>\$ 65,389,069</u>	<u>\$ 127,174,724</u>	<u>\$ (61,785,655)</u>	<u>-49%</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, 2017, were \$940.3 million. Specifically, PCORI's total assets of \$1.033 billion included \$33 million of funds held in trust, \$957.8 million in investments and \$30.5 million in cash. Total liabilities of \$92.7 million represent accounts payable, accrued expenses and deferred rent.

Statements of Activities: In fiscal year 2017, revenue and support totaled \$466.1 million, of which \$120 million came from appropriations, \$105 million from the Federal Hospital Insurance (FHI) and Federal Supplementary Medical Insurance (FSMI) Trust Funds, and \$235.4 million from PCOR fees and \$5.7 million from interest earned on the PCORTF investment portfolio.

For the fiscal year ended September 30, 2017, the revenue of \$466.1 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 2017 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 2017 and FY 2016. The increase from \$345.5 million to \$400.3 million is driven primarily by the growing program services projects; \$357 million was spent on Program Services (or, should you list the 4 details: Research, PCORnet Infrastructure, Engagement, Dissemination projects) that have a life cycle ranging from three to five years.

Patient-Centered Outcomes Research Institute

Management's Discussion and Analysis

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

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, 2017 and 2016, 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, 2017 and 2016, 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.

Emphasis of Matter

As discussed in Note 1, PCORI has adopted Financial Accounting Standards Board Accounting Standard Update 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. Our opinion is not modified with respect to this matter.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our reports dated March 1, 2018 and March 2, 2017, 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 1, 2018

Patient-Centered Outcomes Research Institute

**Statements of Financial Position
September 30, 2017 and 2016**

	2017	2016
Assets		
Cash	\$ 30,541,023	\$ 12,562,788
Short-term investments (Note 2)	957,831,980	-
Amounts held by PCOR Trust Fund (Note 4)	32,979,233	916,536,536
Prepaid expenses	1,685,548	1,127,620
Deposits and other assets	774,091	869,120
Property and equipment, net (Note 5)	9,249,170	8,330,331
	<hr/>	<hr/>
Total assets	\$ 1,033,061,045	\$ 939,426,395
	<hr/> <hr/>	<hr/> <hr/>
Liabilities and Net Assets		
Liabilities:		
Accounts payable and accrued expenses	\$ 91,663,530	\$ 63,031,677
Deferred rent and tenant improvement allowance	1,072,145	1,458,417
Total liabilities	<hr/> 92,735,675	<hr/> 64,490,094
Commitments and contingencies (Notes 6, 7, 8, 9 and 10)		
Net assets:		
Without donor restrictions	940,325,370	874,936,301
	<hr/>	<hr/>
Total liabilities and net assets	\$ 1,033,061,045	\$ 939,426,395
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See notes to financial statements.

Patient-Centered Outcomes Research Institute

Statements of Activities

Years Ended September 30, 2017 and 2016

	2017	2016
Revenue and support (Note 4):		
Federal appropriations	\$ 120,000,000	\$ 120,000,000
Patient-Centered Outcomes Research Fee	235,388,993	252,310,690
Transfers from the Federal Hospital Insurance (FHI) and the Federal Supplementary Medical Insurance (FSMI) Trust Funds	104,954,400	98,698,400
Interest income	5,742,029	1,709,951
Total revenue and support	466,085,422	472,719,041
Expenses:		
Program services:		
Research	246,939,517	239,433,574
PCORnet Infrastructure	76,016,246	49,167,038
Engagement	29,548,142	21,668,992
Dissemination	4,868,761	144,579
	357,372,666	310,414,183
Program support	16,937,477	10,744,564
Administrative Expenses:		
Administrative – general	25,260,363	23,435,890
Administrative – board	772,772	949,680
	26,033,135	24,385,570
Total expenses	400,343,278	345,544,317
Change in net assets before unrealized loss on short-term investments	65,742,144	127,174,724
Unrealized loss on short-term investments	(353,075)	-
Change in net assets	65,389,069	127,174,724
Net assets:		
Beginning	874,936,301	747,761,577
Ending	\$ 940,325,370	\$ 874,936,301

See notes to financial statements.

Patient-Centered Outcomes Research Institute

**Statements of Cash Flows
Years Ended September 30, 2017 and 2016**

	2017	2016
Cash flows from operating activities:		
Change in net assets	\$ 65,389,069	\$ 127,174,724
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation and amortization	5,326,182	3,598,355
Deferred rent	(386,272)	(199,816)
Unrealized loss on short-term investments	353,075	-
Changes in assets and liabilities:		
(Increase) decrease in:		
Amounts held by PCOR Trust Fund	883,557,303	(118,669,041)
Prepaid expenses	(557,928)	9,094,340
Deposits and other assets	95,029	50,516
(Decrease) increase in:		
Accounts payable and accrued expenses	28,631,853	(22,785,940)
Net cash provided by (used in) operating activities	982,408,311	(1,736,862)
Cash flows from investing activities:		
Purchases of property and equipment	(6,245,021)	(4,372,806)
Maturities of short-term investments	605,707,945	-
Purchase of short-term investments	(1,563,893,000)	-
Net cash used in investing activities	(964,430,076)	(4,372,806)
Net increase (decrease) in cash	17,978,235	(6,109,668)
Cash:		
Beginning	12,562,788	18,672,456
Ending	\$ 30,541,023	\$ 12,562,788

See notes to financial statements.

Patient-Centered Outcomes Research Institute

Statement of Functional Expenses Year Ended September 30, 2017

	Program Services				Total Program Services	Program Support	Administrative Expenses			Total
	Research	PCORnet Infrastructure	Engagement	Dissemination			Administrative – General	Administrative – Board	Administrative Expenses	
Research awards	\$ 225,969,661	\$ 73,413,110	\$ 20,116,770	\$ -	\$ 319,499,541	\$ -	\$ -	\$ -	\$ -	\$ 319,499,541
Salaries and wages	10,090,943	1,168,389	2,924,509	566,793	14,750,634	5,857,077	7,418,543	-	7,418,543	28,026,254
Professional services	4,122,166	509,204	3,544,367	3,926,348	12,102,085	4,058,306	7,095,775	16,635	7,112,410	23,272,801
Employee benefits/payroll taxes	2,527,091	309,581	734,864	149,436	3,720,972	1,508,684	1,964,838	-	1,964,838	7,194,494
Depreciation and amortization	1,917,710	222,043	555,781	107,715	2,803,249	1,113,094	1,409,839	-	1,409,839	5,326,182
Travel	542,634	96,315	594,895	10,586	1,244,430	1,402,916	107,580	110,557	218,137	2,865,483
Rent, parking, other occupancy	887,747	103,241	278,159	58,195	1,327,342	556,399	644,995	9,500	654,495	2,538,236
Temporary help	184,384	26,034	99,662	-	310,080	223,105	1,485,651	-	1,485,651	2,018,836
Conferences, conventions, meetings	232,734	154,533	579,698	33,960	1,000,925	1,675,191	292,633	181,132	473,765	3,149,881
Legal fees	-	-	-	-	-	-	602,700	-	602,700	602,700
Reviewer services	166,500	9,500	27,000	-	203,000	313,725	1,000	-	1,000	517,725
Accounting fees	-	-	-	-	-	-	82,500	-	82,500	82,500
Board/committee compensation	214,374	-	-	-	214,374	-	-	429,899	429,899	644,273
Telephone and communications	28,994	3,763	18,026	448	51,231	50,155	309,568	23,485	333,053	434,439
Supplies	1,420	-	225	-	1,645	3,527	161,213	630	161,843	167,015
Information technology	2,599	-	1,500	-	4,099	11,798	2,816,331	-	2,816,331	2,832,228
Other expenses	13	-	3,500	-	3,513	416	214,691	40	214,731	218,660
Insurance – non-employee related	-	-	-	-	-	-	290,509	-	290,509	290,509
Equipment rental and maintenance	-	-	-	-	-	3,261	258,904	-	258,904	262,165
Books, subscriptions, references	48,232	159	60,907	15,205	124,503	134,862	75,091	-	75,091	334,456
Bank/payroll fees	-	-	-	-	-	1,471	13,780	-	13,780	15,251
Postage and shipping	2,315	374	8,279	75	11,043	23,490	14,222	894	15,116	49,649
	\$ 246,939,517	\$ 76,016,246	\$ 29,548,142	\$ 4,868,761	\$ 357,372,666	\$ 16,937,477	\$ 25,260,363	\$ 772,772	\$ 26,033,135	\$ 400,343,278

See notes to financial statements.

Patient-Centered Outcomes Research Institute

Statement of Functional Expenses Year Ended September 30, 2016

	Program Services					Program Support	Administrative Expenses			Total
	Research	PCORnet Infrastructure	Engagement	Dissemination	Total Program Services	Total Program Support	Administrative – General	Administrative – Board	Administrative Expenses	
Research awards	\$ 217,082,614	\$ 46,905,404	\$ 12,332,199	\$ -	\$ 276,320,217	\$ -	\$ -	\$ -	\$ -	\$ 276,320,217
Salaries and wages	12,741,766	-	3,793,625	-	16,535,391	2,351,373	5,754,393	-	5,754,393	24,641,157
Professional services	4,116,063	1,348,500	3,207,494	140,200	8,812,257	4,033,040	5,818,333	197,090	6,015,423	18,860,720
Employee benefits/payroll taxes	1,131,004	-	338,744	-	1,469,748	208,424	4,606,421	-	4,606,421	6,284,593
Depreciation and amortization	1,859,942	-	554,032	-	2,413,974	302,282	882,099	-	882,099	3,598,355
Travel	578,169	251,509	582,959	4,379	1,417,016	788,822	159,793	125,096	284,889	2,490,727
Rent, parking, other occupancy	1,238,947	13,758	367,561	-	1,620,266	405,188	592,423	19,232	611,655	2,637,109
Temporary help	62,449	45,902	109,417	-	217,768	491,346	1,266,620	-	1,266,620	1,975,734
Conferences, conventions, meetings	204,009	589,825	194,633	-	988,467	1,628,217	-	80,558	80,558	2,697,242
Legal fees	-	-	-	-	-	-	689,678	-	689,678	689,678
Reviewer services	156,470	-	25,300	-	181,770	375,500	-	-	-	557,270
Accounting fees	-	-	-	-	-	-	104,916	-	104,916	104,916
Board/committee compensation	191,615	-	-	-	191,615	5,188	-	468,520	468,520	665,323
Telephone and communications	29,697	11,204	34,737	-	75,638	47,042	363,798	57,664	421,462	544,142
Supplies	1,132	-	1,550	-	2,682	4,184	158,184	23	158,207	165,073
Information technology	455	270	3,052	-	3,777	2,889	2,259,185	771	2,259,956	2,266,622
Other expenses	1,619	181	8,634	-	10,434	540	174,763	426	175,189	186,163
Insurance – non-employee related	-	-	-	-	-	-	301,226	-	301,226	301,226
Equipment rental and maintenance	-	-	1,436	-	1,436	4,823	213,202	-	213,202	219,461
Books, subscriptions, references	34,241	283	109,663	-	144,187	68,614	65,082	250	65,332	278,133
Bank/payroll fees	-	-	5	-	5	5	4,750	8	4,758	4,768
Postage and shipping	3,382	202	3,951	-	7,535	27,087	21,024	42	21,066	55,688
	\$ 239,433,574	\$ 49,167,038	\$ 21,668,992	\$ 144,579	\$ 310,414,183	\$ 10,744,564	\$ 23,435,890	\$ 949,680	\$ 24,385,570	\$ 345,544,317

See notes to financial statements.

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) Accounting 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 two classes of net assets: without donor restrictions and with donor restrictions, as applicable. PCORI had no net assets with donor restrictions at September 30, 2017 and 2016.

Short-term investments: Short-term investments with readily determinable fair values are reflected at fair market value. Interest income is included in the accompanying statement of activities. Unrealized gains and losses on investments are excluded from interest income and are presented separately in the statement of activities.

Property and equipment: Property and equipment at September 30, 2017 and 2016, consisted of leasehold improvements, software, furniture, website, 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 and tenant improvement allowance in the accompanying statements of financial position.

Patient-Centered Outcomes Research Institute

Notes to Financial Statements

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

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 (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.

Program awards: PCORI uses contracts as its only means to fund program awards. Expenses are recorded at the time the deliverable has been met or when the cost has been incurred. As of September 30, 2017 and 2016, program awards totaling approximately \$1.87 billion and \$1.55 billion have been entered into, respectively. Prepayments on awards totaling \$208,036 and \$0 are included in prepaid expenses in the statements of financial position at September 30, 2017 and 2016, 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, 2017 and 2016, 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.

Patient-Centered Outcomes Research Institute

Notes to Financial Statements

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

Functional allocation of expenses: The costs of providing various programs and activities have been summarized on a functional basis in the statements of activities. The statements of functional expenses present expenses by function and natural classification. Expenses directly attributed to a specific functional area of PCORI are reported as expenses of those functional areas while shared costs that benefit multiple functional areas have been allocated among the various functional areas based on direct employee salaries charged on each functional area.

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.

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.

Reclassifications: Certain September 30, 2016 amounts have been reclassified to conform to the September 30, 2017 presentation. These reclassifications had no effect on previously stated net assets.

Adopted accounting pronouncements: 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 was to be effective for PCORI for the year ending September 30, 2019. However, PCORI early adopted the ASU during the year ended September 30, 2017.

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.

Patient-Centered Outcomes Research Institute

Notes to Financial Statements

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

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.

Subsequent events: PCORI evaluated subsequent events through March 1, 2018, which is the date the financial statements were available to be issued.

Note 2. Fair Value Measurements

The Fair Value Measurement topic of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (the Codification) defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date and sets out a fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). Inputs are broadly defined as assumptions market participants would use in pricing an asset or liability. The three levels of the fair value hierarchy are described below:

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

Level 2: Observable market-based inputs or unobservable inputs corroborated by market data

Level 3: Unobservable inputs that are not corroborated by market data

The table below presents the balances of assets and liabilities at September 30, 2017, measured at fair value on a recurring basis by level within the hierarchy:

	Total	Level 1	Level 2	Level 3
U.S. treasury bills	\$ 957,831,980	\$ -	\$ 957,831,980	\$ -
Total	\$ 957,831,980	\$ -	\$ 957,831,980	\$ -

The U.S. treasury bills above are classified as Level 2 due to the underlying assets having observable market based inputs for similar, but not identical, assets.

Patient-Centered Outcomes Research Institute

Notes to Financial Statements

Note 3. Liquidity

PCORI regularly monitors liquidity required to meet its annual operating needs and other contractual commitments while also striving to preserve the principal and return on investment of its funds. PCORI's financial assets available within one year of the statements of financial position date to meet cash needs for general expenditures at September 30, 2017, are as follows:

Cash	\$ 30,541,023
Short-term investments	957,831,980
Accounts receivable, net	65,784
Amounts held by PCOR Trust Fund	32,979,233
	<u>\$ 1,021,418,020</u>

PCORI has various sources of liquidity at its disposal including cash and cash equivalents, U.S. treasury bills and amounts held by PCOR Trust Fund. See Notes 2 and 4 for information about amounts held by PCORI in U.S. treasury bills and amounts held by PCOR Trust Fund available to PCORI, respectively.

Note 4. Amounts Held by PCOR Trust Fund

Amounts held by PCORTF available to PCORI at September 30, 2017 and 2016, and activity in the Trust Fund for the years then ended, are as follows:

	<u>2017</u>	<u>2016</u>
Beginning balance	\$ 916,536,536	\$ 797,867,495
Federal appropriations:		
Government fiscal year appropriation	120,000,000	120,000,000
Transfers from FSMI and FHI	104,954,400	98,698,400
Patient-Centered Outcomes Research Fee	235,388,993	252,310,690
Interest earned	1,123,648	1,709,951
Deposits by PCORI - True-up of PCOR fee	14,851,007	-
Draws by PCORI	(1,359,875,351)	(354,050,000)
	<u>\$ 32,979,233</u>	<u>\$ 916,536,536</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.

Patient-Centered Outcomes Research Institute

Notes to Financial Statements

Note 5. Property and Equipment

Property and equipment and accumulated depreciation at September 30, 2017 and 2016, are as follows:

	2017	2016
Leasehold improvements	\$ 6,698,882	\$ 6,445,835
Software development	12,774,413	7,949,462
Website	344,842	-
Furniture, fixtures and equipment	3,927,983	3,744,877
	<u>23,746,120</u>	<u>18,140,174</u>
Less accumulated depreciation	(14,496,950)	(9,809,843)
	<u>\$ 9,249,170</u>	<u>\$ 8,330,331</u>

Note 6. 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, 2017, are as follows:

Years ending September 30:	
2018	\$ 2,770,410
2019	3,061,027
2020	1,227,072
	<u>\$ 7,058,509</u>

Rent expense for the years ended September 30, 2017 and 2016, was \$2,538,236 and \$2,637,109, respectively.

Note 7. 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, 2017 and 2016, were \$41,066,147 and \$40,575,552, respectively. These funds were released from sequester and made available to the PCORTF for obligations on October 1, 2017 and 2016, 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.

Patient-Centered Outcomes Research Institute

Notes to Financial Statements

Note 8. 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 \$2,412,843 and \$2,346,763 for the years ended September 30, 2017 and 2016, respectively.

Note 9. 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.

Note 10. Subsequent Events

On October 30, 2017, November 21, 2017, and December 12, 2017, the Board of PCORI approved research awards totaling \$106 million. The contracts for these projects will be executed in FY 2018. Contracted amounts may differ slightly from the Board approved amounts.

**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

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, 2017, 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 1, 2018.

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 1, 2018