

Independent Auditors' Report

FINANCIAL STATEMENTS

Year Ended June 30, 2016

The Commonwealth Fund

We have audited the accompanying financial statements of The Commonwealth Fund (the "Fund") which comprise the statement of position as of June 30, 2016 and the related statements of activities and of cash flows for the year 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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 auditors' 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 such 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 The Commonwealth Fund as of June 30, 2016 and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Prior Period Financial Statements

The financial statements of the Fund as of June 30, 2015 were audited by other auditors whose report dated November 7, 2015, expressed an unmodified opinion on those statements.

PKF O'Connor Davies, LLP

PKF O'Connor Davies, LLP
New York, New York

November 7, 2016

THE COMMONWEALTH FUND

STATEMENT OF FINANCIAL POSITION

JUNE 30, 2016 with comparative totals for JUNE 30, 2015

	2016	2015
ASSETS		
Cash	\$ 1,834,237	\$ 2,922,502
Investments - At fair value (Notes 1, 3, and 4)	694,920,758	761,076,940
Interest and dividends receivable	111,317	82,464
Proceeds receivable from security sales - net	999,106	32,933
Taxes refundable	31,413	96,086
Prepaid insurance and other assets	89,879	258,407
Landmark property at 1 East 75th Street - At appraised value during 1953, the date of donation	275,000	275,000
Furniture, equipment and building improvements - At cost, net of accumulated depreciation of \$3,567,990 at June 30, 2016 (Note 2)	<u>4,357,770</u>	<u>4,012,868</u>
TOTAL ASSETS	<u><u>\$ 702,619,480</u></u>	<u><u>\$ 768,757,200</u></u>
LIABILITIES AND NET ASSETS		
LIABILITIES:		
Accounts payable and accrued expenses	\$ 907,799	\$ 686,054
Program authorizations payable, net (Note 5)	19,062,714	19,847,260
Accrued postretirement benefits (Note 6)	7,356,415	6,459,816
Deferred tax liability (Note 7)	<u>1,564,651</u>	<u>2,789,685</u>
Total liabilities	28,891,579	29,782,815
NET ASSETS - Unrestricted	<u>673,727,901</u>	<u>738,974,385</u>
Total net assets	<u>673,727,901</u>	<u>738,974,385</u>
TOTAL LIABILITIES AND NET ASSETS	<u><u>\$ 702,619,480</u></u>	<u><u>\$ 768,757,200</u></u>

See notes to financial statements.

THE COMMONWEALTH FUND

STATEMENT OF ACTIVITIES

YEAR ENDED JUNE 30, 2016 with comparative totals for JUNE 30, 2015

	2016	2015
INVESTMENT GAINS, LOSSES, REVENUES AND OTHER:		
Net realized gains on investments	\$ 30,221,979	\$ 42,725,794
Change in unrealized appreciation of investments	(61,158,647)	(1,913,969)
Interest and dividends	2,228,064	2,430,552
	<u>(28,708,604)</u>	<u>43,242,377</u>
Less: Investment expenses	(3,538,918)	(5,076,323)
Taxes benefit (provision) (Note 7)	456,827	(920,702)
	<u>(31,790,695)</u>	<u>37,245,352</u>
Net investment gains (losses)	(31,790,695)	37,245,352
Partner grants, royalties and other	934,124	(17,378)
	<u>(30,856,571)</u>	<u>37,227,974</u>
EXPENSES:		
Program authorizations	21,467,875	19,393,707
Operating programs (Note 8)	9,520,663	9,375,210
General administration	2,404,290	2,118,878
Retirement and other postretirement (Note 6)	997,085	1,462,425
	<u>34,389,913</u>	<u>32,350,220</u>
Total expenses	34,389,913	32,350,220
CHANGES IN UNRESTRICTED NET ASSETS	(65,246,484)	4,877,754
Net assets, beginning of year	<u>738,974,385</u>	<u>734,096,631</u>
Net assets, end of year	<u>\$ 673,727,901</u>	<u>\$ 738,974,385</u>

See notes to financial statements.

THE COMMONWEALTH FUND

STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2016 with comparative totals for JUNE 30, 2015

	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash provided (used) by interest and dividends	\$ 2,199,211	\$ 2,525,445
Cash provided (used) by royalties and other	934,124	(17,378)
Cash provided (used) to pay grants	(22,252,421)	(18,857,240)
Cash provided (used) to pay program expenses	(9,298,918)	(9,732,443)
Cash provided (used) to pay administrative expenses	(2,235,762)	(1,756,668)
Cash provided (used) to pay taxes	(703,534)	(201,500)
Cash provided (used) to pay investment expenses	(3,538,918)	(5,076,323)
Cash provided (used) to pay unfunded retirement expenses	<u>(100,486)</u>	<u>(219,859)</u>
Net cash used by operating activities	(34,996,704)	(33,335,966)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of furniture, equipment and building improvements - net	(637,842)	(230,730)
Purchase of investments	(90,143,167)	(145,073,460)
Proceeds from the sale of investments	<u>124,689,448</u>	<u>180,126,610</u>
Net cash provided by investing activities	<u>33,908,439</u>	<u>34,822,420</u>
Net (decrease) increase in cash	(1,088,265)	1,486,454
Cash, beginning of year	<u>2,922,502</u>	<u>1,436,048</u>
Cash, end of year	<u><u>\$ 1,834,237</u></u>	<u><u>\$ 2,922,502</u></u>

See notes to financial statements.

THE COMMONWEALTH FUND

NOTES TO FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2016

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Commonwealth Fund (the “Fund”) is a private foundation supporting independent research on health and social issues.

- a. *Investments* - Investments in equity securities with readily determinable fair values and all investments in debt securities are carried at fair value, which approximates market value. Assets with limited marketability, such as alternative asset limited partnerships, are stated at the Fund’s equity interest in the underlying net assets of the partnerships, which are stated at fair value as reported by the partnerships. Realized gains and losses on dispositions of investments are determined on the following bases: FIFO for actively managed equity and fixed income, average cost for commingled mutual funds, and specific identification basis for alternative assets.
- b. *Fixed Assets* - Furniture, equipment, and building improvements are capitalized at cost and depreciated using the straight-line method over their estimated useful lives. The landmark property is recorded at fair value at date of donation and is not depreciated but subject to impairment testing.
- c. *Grants, Promises to Give, and Net Assets Classifications* - Grants are recognized in the period received. Grants are recorded as receivable and revenue when a written agreement is received. The Fund reports grants as restricted if received with a donor stipulation that limits the use of the donated assets.* Unconditional promises to give for future periods are recorded when authorized by the Board and are presented as program authorizations payable on the statement of financial position, which includes a discount for present value.
- d. *Use of Estimates* - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (US GAAP) requires the Fund’s management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses from the statement of activities. The calculation of the present value of program authorizations payable, present value of accumulated postretirement benefits, deferred Federal excise taxes and the depreciable lives of fixed assets requires the significant use of estimates. Actual results could differ from those estimates.
- e. *Cash* – Cash consists of all checking accounts and petty cash.

At times the Fund’s cash exceeds federally insured limits. This risk is managed by using only large, established financial institutions.

*Accordingly, net assets and changes therein are reported as an increase in unrestricted net assets. There are no temporarily or permanently restricted net assets as of June 30, 2016.

2. FIXED ASSETS

Fixed assets at June 30, 2016 were comprised of the following:

	Cost	Accumulated Depreciation	Book Value	Useful Life
Building improvements	\$ 6,498,056	\$ 2,614,883	\$ 3,883,173	7-40 years
Computers and related	449,877	345,303	104,574	3-10 years
Furniture, fixtures and equipment	<u>977,827</u>	<u>607,804</u>	<u>370,023</u>	5-20 years
Total	<u>\$ 7,925,760</u>	<u>\$ 3,567,990</u>	<u>\$ 4,357,770</u>	

3. INVESTMENTS

Investments at June 30, 2016 comprised the following:

	Fair Value	Cost
Global Equity	\$ 283,122,277	\$ 220,761,605
Alternative Equity	196,396,139	156,594,286
Private Partnerships	160,801,742	190,655,957
Fixed Income	42,909,561	35,688,535
Cash and Miscellaneous	<u>11,691,039</u>	<u>11,691,039</u>
	<u>\$ 694,920,758</u>	<u>\$ 615,391,422</u>

At June 30, 2016, the Fund had total unexpended investment commitments of approximately \$90 million in private partnerships.

The Fund's investment managers may use futures contracts to manage asset allocation and to adjust the duration of the fixed income portfolio. In addition, investment managers may use foreign exchange forward contracts to minimize the exposure of certain Fund investments to adverse fluctuations in the financial and currency markets. At June 30, 2016 the Fund had 123 contracts with a notional value of \$9,000,000 in outstanding derivative positions. The unrealized gain on these positions is \$15,000, which is included in unrealized gains and losses. The contracts held were:

- 32 S&P 500 EMINI IND FUT (CME)
- 56 MSCI EAFE INDEX FUTURE (NYP)
- 35 MINI MSCI EMG MKT FUTURE (NYF)

Fair Value Measurements

The Fund follows US GAAP guidance on Fair Value Measurements which defines fair value and establishes a fair value hierarchy organized into three levels based upon the input assumptions used in pricing assets. Level 1 inputs have the highest reliability and are related to assets with unadjusted quoted prices in active markets. Level 2 inputs relate to assets with other than quoted prices in active markets which may include quoted prices for similar assets or liabilities or other inputs which can be corroborated by observable market data. Level 3 inputs are unobservable inputs and are used to the extent that observable inputs do not exist.

In May 2015, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2015-07, Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share (or Its Equivalent), which removes the requirement to categorize, within the fair value hierarchy, all investments measured using net asset value (“NAV”) as a practical expedient. ASU 2015-07 was adopted by the Fund for its June 30, 2016 financial statements and requires retrospective application. The adoption has no effect on the reported values of these investments.

Investments Valuation

Investments, other than cash held for investment, are carried at fair value. The fair value of alternative investments has been estimated using the NAV as reported by the management of the respective alternative investment fund. U.S. GAAP guidance provides for the use of NAV as a “Practical Expedient” for estimating fair value of alternative investments. NAV, member’s capital, partner’s capital, or any investor ownership amount reported by each alternative investment fund is used as a practical expedient to estimate the fair value of the Fund’s interest therein.

Investments Risks and Uncertainties

Alternative investments consist of non-traditional, not readily marketable investments, some of which may be structured as offshore limited partnerships, venture capital funds, hedge funds and private equity funds. The underlying investments of such funds, whether invested in stock or other securities, are generally not currently traded in a public market and typically are subject to restrictions on resale. Values determined by investment managers and general partners of underlying securities that are thinly traded or not traded in an active market may be based on historical cost, appraisals, a review of the investees’ financial results, financial condition and prospects, together with comparisons to similar companies for which quoted market prices are available or other estimates that require varying degrees of judgment.

Because of the inherent uncertainty of valuations, the estimated fair values may differ significantly from the values that would have been used had a ready market for such investments existed or had such investments been liquidated, and those differences could be material. It is estimated that the limited partnerships will be liquidated over the next 5-7 years.

Investments

The following tables summarize investments valued at fair value on a recurring basis at June 30, grouped by the fair value hierarchy, for those investments subject to categorization within such hierarchy:

	Fair Value Measurements Using		
	Fair Value	Quoted in Active Markets For Identical Assets	Significant Other Observable Inputs
		Level 1	Level 2
Global equity–Preferred stock	\$ 158,120	\$ 158,120	–
Fixed income–US Treasuries	21,420,737	1,440,566	\$ 19,980,171
Fixed income–Funds	<u>21,488,824</u>	<u>–</u>	<u>21,488,824</u>
Total	<u>\$ 43,067,681</u>	<u>\$ 1,598,686</u>	<u>\$ 41,468,995</u>

There were no transfers between level 1 and 2 of the fair value hierarchy during the year ended June 30, 2016.

Total investments at June 30, 2016 include those classified within the fair value hierarchy, as well as those measured using NAV as a practical expedient and cash held for reinvestment, as follows:

Investments included in fair value hierarchy	\$ 43,067,681
Nonpublic investments measured using net asset value	
Global equity	282,964,157
Alternative equity	196,396,139
Limited partnerships:	
Private equity	100,429,465
Oil and gas	15,236,610
Real estate	14,249,729
Venture capital	30,885,938
Cash	<u>11,691,039</u>
Total investments	<u>\$ 694,920,758</u>

Information regarding alternative investments valued at NAV using the practical expedient at June 30, 2016 is as follows:

	Fair value	Unfunded Commitments	Redemption frequency	Notice period
Global equity	\$ 282,964,157		Monthly, Quarterly	100, 120 days
Alternative equity	196,396,139		Quarterly	90 days
Limited partnerships:		\$ 90,000,000	N/A	
Private equity	100,429,465			
Oil and gas	15,236,610			
Real estate	14,249,729			
Venture capital	30,885,938			
	<u>\$ 640,162,038</u>			

4. FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair value amounts have been determined by the Fund, using available market information and appropriate valuation methodologies. However, considerable judgment is necessarily required in interpreting market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts that the Fund could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

All Financial Instruments Other Than Investments - The carrying amounts of these items are a reasonable estimate of their fair value.

Investments - For marketable securities held as investments, fair value equals quoted market price, if available. If a quoted market price is not available, fair value is estimated using quoted market price for similar securities. For alternative asset limited partnerships held as investments, fair value is estimated using private valuations of the securities or properties held in these partnerships. The carrying amount of these items is a reasonable estimate of their fair value. For futures and foreign exchange forward contracts, the fair value equals the quoted market price.

5. PROGRAM AUTHORIZATIONS PAYABLE

At June 30, 2016, program authorizations scheduled for payment at later dates were as follows:

July 1, 2016 through June 30, 2017	\$ 13,364,979
July 1, 2017 through June 30, 2018	3,818,565
Thereafter	<u>1,909,283</u>
Gross program authorizations scheduled for payment at a later date	19,092,827
Less adjustment to present value	<u>30,113</u>
Program authorizations payable	<u>\$ 19,062,714</u>

A discount rate of 0.92% (based on the one month LIBOR plus 45 basis points) was used to determine the present value of the program authorizations payable at June 30, 2016.

6. RETIREMENT AND OTHER POSTRETIREMENT BENEFITS

The Fund has a noncontributory defined contribution retirement plan, covering all employees, under arrangements with TIAA and Fidelity Investments. This plan provides for purchases of annuities and/or mutual funds for employees. The Fund's contributions approximated 17% of the participants' compensation for the year ended June 30, 2016. Contributions to the Fund's defined contribution retirement plan were \$1,131,380 for the year ended June 30, 2016. In addition, the plan allows employees to make voluntary tax-deferred purchases of these same annuities and/or mutual funds within the legal limits provided for under Federal law.

Effective July 9, 2002, the Fund established a Section 457(b) Plan for certain employees that provides for unfunded benefits with employer contributions made within the legal limits provided for under Federal law.

The Fund provides postretirement medical insurance coverage for retirees who meet the eligibility criteria. The postretirement medical plan, which is measured as of the end of each fiscal year, is an unfunded plan, with 100% of the benefits paid by the Fund on a pay-as-you-go basis. Such medical insurance payments approximated \$189,243 for the year ended June 30, 2016. Additionally, \$7,321 was directly paid for retiree medical expenses, resulting in a total employer contribution of \$196,564.

Contributions under the postretirement medical plan for the fiscal year ended June 30, 2016 were approximately \$190,000. Additional required disclosure on the Fund's postretirement medical plan for the years ended June 30, 2016:

Benefit obligation at June 30	\$ 7,356,415
Fair value of plan assets at June 30	—
Status - unfunded	<u>7,356,415</u>
Actuarial loss	—
Accrued benefit cost recognized	<u>\$ 7,356,415</u>
Net periodic expense ⁽¹⁾	\$ 1,093,213
Employer contribution	\$ 196,564

- (1) Net periodic expense is the change in the benefit obligation from the previous year plus the employer contribution.

Significant assumptions related to postretirement benefits as of June 30, 2016 were as follows:

Discount rate ⁽²⁾	5.2%
Health care cost trend rates - Initial	4.3%
Health care cost trend rates - Ultimate	7.0%

- (2) Trailing 10-year return on the endowment.

At June 30, 2016, benefits expected to be paid in future years are approximately as follows:

Year ending June 30, 2017	\$ 169,591
Year ending June 30, 2018	195,258
Year ending June 30, 2019	198,362
Year ending June 30, 2020	201,515
Year ending June 30, 2021	204,719
Five years ending June 30, 2026	1,003,856

7. TAX STATUS

The Fund is exempt from Federal income taxes under Section 501(c)(3) of the Internal Revenue Code, but is subject to a 1% or 2% (depending if certain criteria are met) Federal excise tax on net investment income. For the year ended June 30, 2016 that excise tax rate was 1%. The Fund is also subject to Federal and state taxes on unrelated business income. In addition, the Fund records deferred Federal excise taxes, based upon expected excise tax rates, on the unrealized appreciation of investments as such amounts would be realized for tax purposes when the investments are sold.

The Fund is required to make certain minimum distributions in accordance with a formula specified by the Internal Revenue Service. For the year ended June 30, 2016, the Fund was required to distribute approximately \$35.0 million. The Fund has an undistributed amount of approximately \$11.0 million carried over to the next fiscal year.

In the Statement of Financial Position, the deferred tax liability of \$1,564,651 at June 30, 2016 resulted from expected Federal excise taxes on unrealized appreciation of investments. For the year ended June 30, 2016 there was a reduction of \$1,225,034 in the deferred excise tax liability.

8. OPERATING PROGRAMS

The Fund is a value-added foundation, working directly with grantees to develop projects, carry them out effectively and communicate results to policymakers and institutional leaders. It also conducts a large program of intramural research including national and international health care surveys and development and production of scorecards on health system performance. Operating programs include the non-grant expenses related to these activities in areas such as International Health Policy, Communications, Health Care Coverage and Access, and Tracking Health System Performance.

9. FINANCIAL STATEMENT HIGHLIGHTS

For the following items, all original amounts have been fully expended.

In fiscal years 1987 and 1988, the Fund received a total of \$15,415,804 as a grant from the James Picker Foundation (which has been fully expended), with an agreement that a designated portion of the Fund's grants be identified as "Picker Program Grants by The Commonwealth Fund." The Fund fulfills this obligation by making Picker Program Grants devoted to specific themes approved by the Fund's Board of Directors. For the year ended June 30, 2016 Picker program grants totaled \$1,575,850.

In April 1996, the Fund received The Health Services Improvement Fund, Inc.'s ("HSIF") assets and liabilities, \$1,721,016 and \$57,198, respectively, resulting in a \$1,663,818 increase in net assets (which has been fully expended). In accordance with the terms of an agreement with HSIF, this contribution enables the Fund to make Commonwealth Fund/HSIF grants to improve health care coverage, access, and quality in the New York City greater metropolitan region. During the year ended June 30, 2016 a grant in the amount of \$163,492 was awarded.

During the year ended June 30, 2002, the Fund received a bequest of \$3,001,124 from the estate of Professor Frances Cooke Macgregor as a contribution to the general endowment, with the amount of annual grants generated by this addition to the endowment to be governed by the Fund's overall annual payout policies. An additional amount of \$100,000 was received during the year ended June 30, 2004 (both bequests have been fully expended). This gift was made with the provisions that in at least the five-year period following its receipt, grants made possible by it will be used to address iatrogenic medicine issues, and that grants made possible by the gift be designated "Frances Cooke Macgregor" grants. During the year ended June 30, 2016 the Frances Cooke Macgregor grant totaled \$409,855.

10. UNCERTAIN TAX POSITION

The Fund has not entered into any uncertain tax positions that would require financial statement recognition or disclosure. The Fund is no longer subject to audits by the applicable taxing jurisdiction for periods prior to June 30, 2013.

11. LINE OF CREDIT

The Fund has an unsecured, committed line of credit with Bank of America in the amount of \$20 million. The Fund did not use this facility during the year ended June 30, 2016.

12. SUBSEQUENT EVENTS

In connection with the preparation of the financial statements, the Fund evaluated subsequent events after the statement of financial position date of June 30, 2016 through November 7, 2016 which was the date the financial statements were available to be issued.

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