

The Commonwealth Fund

Independent Auditors' Report

Financial Statements

Years Ended June 30, 2011 and 2010

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INDEPENDENT AUDITORS' REPORT

The Commonwealth Fund

We have audited the accompanying statements of financial position of The Commonwealth Fund (the "Fund") as of June 30, 2011 and 2010 and the related statements of activities and of cash flows for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Fund at June 30, 2011 and 2010 and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.



November 7, 2011

THE COMMONWEALTH FUND

STATEMENTS OF FINANCIAL POSITION JUNE 30, 2011 AND 2010

	2011	2010
ASSETS		
CASH	\$ 1,286,376	\$ 1,300,500
INVESTMENTS - At fair value (Notes 1 and 2)	679,363,908	597,134,926
INTEREST AND DIVIDENDS RECEIVABLE	45,124	74,177
PROCEEDS RECEIVABLE FROM SECURITY SALES - NET	3,493,372	492,525
TAXES REFUNDABLE	755,008	609,945
PREPAID INSURANCE AND OTHER ASSETS	311,622	324,088
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 \$2,152,492 at June 30, 2011 and \$1,848,540 at June 30, 2010 (Note 1)	<u>4,662,659</u>	<u>4,313,804</u>
TOTAL ASSETS	<u>\$ 690,193,069</u>	<u>\$ 604,524,965</u>
LIABILITIES AND NET ASSETS		
LIABILITIES:		
Accounts payable and accrued expenses	\$ 2,041,355	\$ 1,362,171
Program authorizations payable (Note 3)	20,308,399	24,418,124
Accrued postretirement benefits (Note 4)	4,776,443	4,539,962
Deferred tax liability (Note 5)	<u>2,734,441</u>	<u>1,339,221</u>
Total liabilities	<u>29,860,638</u>	<u>31,659,478</u>
NET ASSETS:		
Unrestricted	<u>660,332,431</u>	<u>572,865,487</u>
Total net assets	<u>660,332,431</u>	<u>572,865,487</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 690,193,069</u>	<u>\$ 604,524,965</u>

See notes to financial statements.

THE COMMONWEALTH FUND

STATEMENTS OF ACTIVITIES YEARS ENDED JUNE 30, 2011 AND 2010

	2011	2010
REVENUES AND SUPPORT:		
Interest and dividends	\$ 8,353,660	\$ 7,876,340
Contribution and other revenue	<u>587</u>	<u>43,645</u>
Total revenues and support	<u>8,354,247</u>	<u>7,919,985</u>
EXPENSES:		
Program authorizations and operating program	27,984,516	31,612,976
General administration	1,836,709	1,869,540
Investment management	3,821,723	3,670,564
Taxes (Note 5)	1,888,005	1,199,562
Retirement and other postretirement (Note 4)	<u>628,950</u>	<u>2,809,234</u>
Total expenses	<u>36,159,903</u>	<u>41,161,876</u>
EXCESS OF EXPENSES OVER REVENUES BEFORE NET INVESTMENT GAINS	<u>(27,805,656)</u>	<u>(33,241,891)</u>
NET INVESTMENT GAINS		
Net realized gains on investments	45,511,613	27,160,110
Change in unrealized appreciation of investments	<u>69,760,987</u>	<u>44,259,135</u>
Total net investment gains	<u>115,272,600</u>	<u>71,419,245</u>
CHANGES IN UNRESTRICTED NET ASSETS	<u>87,466,944</u>	<u>38,177,354</u>
Net assets, beginning of year	<u>572,865,487</u>	<u>534,688,133</u>
Net assets, end of year	<u>\$ 660,332,431</u>	<u>\$ 572,865,487</u>

See notes to financial statements.

THE COMMONWEALTH FUND

STATEMENTS OF CASH FLOWS YEARS ENDED JUNE 30, 2011 AND 2010

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash provided by interest, dividends, and other	\$ 8,383,300	\$ 7,961,340
Cash used to pay grants and program expenses	(31,415,057)	(26,252,893)
Cash used to pay administrative expenses	(1,520,291)	(1,907,392)
Cash used to pay investment expenses	(3,821,723)	(3,670,564)
Cash used to pay taxes (refunds)	(637,848)	889,527
Cash used to pay unfunded retirement expenses	<u>(392,469)</u>	<u>(463,454)</u>
Net cash used by operating activities	<u>(29,404,088)</u>	<u>(23,443,436)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of furniture, equipment, and building improvements - net	(652,807)	(147,461)
Purchase of investments	(109,230,230)	(125,170,744)
Proceeds from the sale of investments	<u>139,273,001</u>	<u>150,004,758</u>
Net cash provided by investing activities	<u>29,389,964</u>	<u>24,686,553</u>
NET INCREASE (DECREASE) IN CASH	(14,124)	1,243,117
CASH, BEGINNING OF YEAR	<u>1,300,500</u>	<u>57,383</u>
CASH, END OF YEAR	<u>\$ 1,286,376</u>	<u>\$ 1,300,500</u>
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Change in net assets for the year	\$ 87,466,944	\$ 38,177,354
Depreciation	303,952	286,236
Net investment gains	(115,272,600)	(71,419,245)
Decrease in interest and dividends receivable	29,053	41,355
Decrease (increase) in taxes refundable - net	(145,063)	1,203,907
Decrease (increase) in prepaid insurance and other assets	12,466	(324,088)
Increase in accounts payable and accrued expenses	679,184	263,471
Increase (decrease) in program authorizations payable	(4,109,725)	5,096,612
Increase in accrued post retirement benefits	236,481	2,345,780
Increase in deferred tax liability	<u>1,395,220</u>	<u>885,182</u>
Net cash used in operating activities	<u>\$ (29,404,088)</u>	<u>\$ (23,443,436)</u>

See notes to financial statements.

THE COMMONWEALTH FUND

NOTES TO FINANCIAL STATEMENTS YEARS ENDED JUNE 30, 2011 AND 2010

I. 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.

The Fund records derivative instruments in the statements of financial position at their fair value, with changes in fair value being recorded in the statement of activities. The Fund does not hold or issue financial instruments, including derivatives, for trading purposes. Both realized and unrealized gains and losses are recognized in the statements of activities.

- b. *Fixed Assets* - Furniture, equipment, and building improvements are capitalized at cost and depreciated using the straight-line method over their estimated useful lives.
- c. *Contributions, Promises to Give, and Net Assets Classifications* - Contributions received and made, including unconditional promises to give, are recognized in the period incurred. The Fund reports contributions 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 at fair values, which includes a discount for present value.
- d. *Use of Estimates* - The preparation of financial statements in conformity with generally accepted accounting principles 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 additions to and deductions 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.

2. INVESTMENTS

Investments at June 30, 2011 and 2010 comprised the following:

	2011		2010	
	Fair Value	Cost	Fair Value	Cost
U.S. Equities	\$ 92,323,471	\$ 76,145,579	\$ 80,387,617	\$ 83,534,330
Non - U.S. Equities	130,999,782	107,278,926	104,167,492	91,678,376
Fixed income	71,003,503	61,925,158	94,489,324	87,488,048
Short-term	15,528,170	15,527,549	15,087,701	15,087,701
Marketable alternative equity	160,233,469	92,113,165	134,247,901	79,872,435
Nonmarketable alternative equity	75,214,657	78,017,648	61,307,334	67,855,885
Inflation hedge	<u>134,060,856</u>	<u>111,634,027</u>	<u>107,447,557</u>	<u>104,657,084</u>
	<u>\$679,363,908</u>	<u>\$542,642,052</u>	<u>\$597,134,926</u>	<u>\$530,173,859</u>

At June 30, 2011, the Fund had total unexpended investment commitments of approximately \$75.2 million. (\$26.0 million for private equity, \$17.9 million for venture capital, \$13.2 million for natural resources, \$9.7 million for real estate and \$8.4 million for inflation hedge)

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, 2011 and 2010, the Fund had no outstanding derivative positions.

Fair value of an investment is the amount that would be received to sell the investment in an orderly transaction between market participants at the measurement date.

Accounting guidance establishes a hierarchal disclosure framework which prioritizes and ranks the level of market price observability used in measuring investments at fair value. Market price observability is impacted by a number of factors, including type of investment and the characteristics specific to the investment. Investments with readily available active quoted prices or for which fair value can be measured from actively quoted prices generally will have a higher degree of market price observability and a lesser degree of judgment used in measuring fair value.

Investments measured and reported at fair value are classified and disclosed in one of the following categories.

Level 1 Inputs – Quoted prices in active markets for identical investments. In the case of funds, a reported NAV and full liquidity.

Level 2 Inputs – Other significant observable inputs (including quoted prices for similar investments, interest rates, etc). Hedge funds with reported NAV are included in this category. The Fund requires investments classified as level two to have at least quarterly liquidity.

Level 3 Inputs – Prices determined using significant unobservable inputs. Unobservable inputs reflect the Fund's own assumptions about the factors market participants would use in pricing an investment and would be based on the best information available. Investments included in this category

generally include private equity, venture capital, real estate, natural resources, gas and oil, and hedge fund investments with limited liquidity. The fund invests in these investments to diversify its portfolio. The level three illiquid investments only have redemptions when underlying investments are sold. The Fund expects the terms of these investments to last up to twelve years.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, an investment's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

Investments are categorized as follows:

	2011			
	Total	Level 1	Level 2	Level 3
U.S. Equities				
Growth fund	\$ 18,843,475	\$ 18,843,475		
U.S. equity fund	17,184,600	17,184,600		
Consumer goods	10,802,029	10,802,029		
Services	10,310,580	10,310,580		
Finance	8,086,628	8,086,628		
Equipment	7,766,879	7,766,879		
Energy	7,628,074	7,628,074		
Other	11,701,206	11,701,206		
Non - U.S. Equities	130,999,782	130,999,782		
Fixed income				
Corporate	1,663,340		\$ 1,663,340	
Funds	69,340,163	42,338,160	27,002,003	
Short-term	15,528,170	15,528,170		
Marketable alternative equity	160,233,469	5,299,788	154,849,054	\$ 84,627
Nonmarketable private equity	37,062,297			37,062,297
Nonmarketable venture capital	38,152,360			38,152,360
Inflation hedge				
Diversified	39,488,392	39,488,392		
Gold funds	16,328,630	16,328,630		
Energy	45,117,240	20,429,396		24,687,844
Real estate	25,685,408			25,685,408
TIPS	7,441,186	7,441,186		
	<u>\$679,363,908</u>	<u>\$370,176,975</u>	<u>\$183,514,397</u>	<u>\$125,672,536</u>

2010

	Total	Level 1	Level 2	Level 3
U.S. Equities	\$ 80,387,617	\$ 80,387,617		
Non-U.S. Equities	104,167,492	104,167,492		
Fixed Income	94,489,324	71,273,790	\$ 23,215,534	
Short-term	15,087,701	15,087,701		
Marketable alternative equity	134,247,901	5,156,944	128,978,131	\$ 112,826
Nonmarketable alternative equity	61,307,334			61,307,334
Inflation hedge	<u>107,447,557</u>	<u>72,369,988</u>		<u>35,077,569</u>
	<u>\$ 597,134,926</u>	<u>\$ 348,443,532</u>	<u>\$ 152,193,665</u>	<u>\$ 96,497,729</u>

The change in level three assets for 2011 is as follows:

	Balance 6/30/2010	Capital Additions	Distributions	Income	Balance 6/30/2011
Marketable alternative equity	\$ 112,826		\$ 28,199		\$ 84,627
Nonmarketable private equity	34,069,718	\$ 7,230,679	11,235,511	\$ 6,997,411	37,062,297
Nonmarketable venture capital	27,237,616	6,942,053	4,139,343	8,112,034	38,152,360
Inflation hedge - energy	21,989,034	4,075,284	6,311,535	4,935,061	24,687,844
Inflation hedge real estate	<u>13,088,535</u>	<u>8,428,454</u>	<u>1,369,484</u>	<u>5,537,903</u>	<u>25,685,408</u>
	<u>\$ 96,497,729</u>	<u>\$ 26,676,470</u>	<u>\$ 23,084,072</u>	<u>\$ 25,582,409</u>	<u>\$ 125,672,536</u>

The change in level three assets for 2010 is as follows:

	Marketable Alt. Equity	Nonmarketable Alt. Equity	Inflation Hedge	Total
Balance 6/30/09	\$ 84,218	\$ 53,148,235	\$ 29,086,428	\$ 82,318,881
Net additions	(853,681)	4,874,223	3,863,698	7,884,240
Investment return	(19,179)	3,284,876	2,127,443	5,393,140
Transfers between levels	<u>901,468</u>			<u>901,468</u>
Balance	<u>\$ 112,826</u>	<u>\$ 61,307,334</u>	<u>\$ 35,077,569</u>	<u>\$ 96,497,729</u>

3. PROGRAM AUTHORIZATIONS PAYABLE

At June 30, 2011, program authorizations scheduled for payment at later dates were as follows:

July 1, 2011 through June 30, 2012	\$ 16,038,324
July 1, 2012 through June 30, 2013	4,125,285
Thereafter	<u>217,120</u>
Gross program authorizations scheduled for payment at a later date	20,380,729
Less adjustment to present value	<u>72,330</u>
Program authorizations payable	<u>\$ 20,308,399</u>

A discount rate of 1.75 % was used to determine the present value of the program authorizations payable at June 30, 2011

4. RETIREMENT AND OTHER POSTRETIREMENT BENEFITS

The Fund has a noncontributory defined contribution retirement plan, covering all employees, under arrangements with Teachers Insurance and Annuity Association of America and College Retirement Equities Fund 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 years ended June 30, 2011 and 2010. Pension expense under this plan was approximately \$1,013,000 and \$983,000 for the years ended June 30, 2011 and 2010, respectively. 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 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 payments approximated \$148,000 and \$118,000 for each of the years ended June 30, 2011 and 2010.

Expected contributions under the postretirement medical plan for the fiscal year ended June 30, 2012 are expected to be approximately \$179,000. Additional required disclosure on the Fund's postretirement medical plan for the years ended June 30, 2011 and 2010 is as follows:

	2011	2010
Benefit obligation at June 30	\$ 4,776,443	\$ 4,539,962
Fair value of plan assets at June 30	<u>-</u>	<u>-</u>
Status - unfunded	4,776,443	4,539,962
Actuarial loss	<u>-</u>	<u>-</u>
Accrued benefit cost recognized	<u>\$ 4,776,443</u>	<u>\$ 4,539,962</u>
Net periodic expense	\$ 973,334	\$ 2,463,956
Employer contribution	\$ 148,380	\$ 118,176

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

	2011	2010
Discount rate	7.7%	2.7%
Health care cost trend rates – Initial	6.3%	7.3%
Health care cost trend rates – Ultimate	6.3%	7.1%

At June 30, 2011, benefits expected to be paid in future years are approximately as follows:

Year ended June 30, 2012	\$ 166,000
Year ended June 30, 2013	\$ 175,000
Year ended June 30, 2014	\$ 185,000
Year ended June 30, 2015	\$ 185,000
Year ended June 30, 2016	\$ 172,000
Five years ended June 30, 2021	\$ 836,000

5. 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 years ended June 30, 2011 and 2010, 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 or depreciation of investments being reported for financial reporting purposes in different periods than for tax purposes.

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, 2011, distributions approximating \$1.6 million are required to be made by June 30, 2012 to satisfy the minimum requirements of approximately \$32.2 million for the year ended June 30, 2011.

In the Statements of Financial Position, the deferred tax liability of \$2,734,441 and \$1,339,221 at June 30, 2011 and 2010, respectively, resulted from expected Federal excise taxes on unrealized appreciation of investments.

For the years ended June 30, 2011 and 2010, the tax provision was as follows:

	2011	2010
Excise taxes - current	\$ 492,785	\$ 314,380
Excise taxes - deferred	1,395,220	885,182
Unrelated business income taxes - current	-	-
Total Taxes	<u>\$ 1,888,005</u>	<u>\$ 1,199,562</u>

6. 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.

7. CONTRIBUTIONS RECEIVED

In fiscal years 1987 and 1988, the Fund received a total of \$15,415,804 as a grant from the James Picker Foundation, 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 years ended June 30, 2011 and 2010, Picker program grants totaled approximately \$1,960,000 and \$1,960,000, respectively.

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. 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 years ended June 30, 2011 and 2010, grants in the amount of \$224,000 and \$414,000 were 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. 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 years ended June 30, 2011 and 2010, the Frances Cooke Macgregor grants totaled approximately \$390,000 and \$350,000, respectively.

8. UNCERTAIN TAX POSITION

The Fund has not entered into any uncertain tax positions that would require financial statement recognition. The Fund is no longer subject to audits by the applicable taxing jurisdiction for periods prior to June 30, 2008.

9. 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, 2011 through November 7, 2011 which was the date the financial statements were available to be issued.

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