HEALTH CARE INCENTIVES IMPROVEMENT INSTITUTE, INC.

Financial Statements
for the years ended December 31, 2012 and 2011

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Health Care Incentives Improvement Institute, Inc.:

We have audited the accompanying statements of financial position of Health Care Incentives Improvement Institute, Inc. (a nonprofit organization) as of December 31, 2012 and 2011, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Health Care Incentives Improvement Institute, Inc. as of December 31, 2012 and 2011 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.

Actis-Grande, Ronan & Company, LLC

April 19, 2013

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Health Care Incentives Improvement Institute, Inc.
Statements of Financial Position
as of December 31,

	2012	2011
Assets		
Cash and cash equivalents	**$ 319,770**	$ 415,675
Accounts receivable	**375,000**	425,042
Investments	**1,036,384**	1,054,007
Grants and contracts receivable	**255,423**	17,310
Property and equipment, net of accumulated depreciation	**28,833**	41,099
Total assets	**$ 2,015,410**	$ 1,953,133
Liabilities and Net Assets		
Accounts payable and accrued expenses	**$ 150,705**	$ 144,533
Deferred license and grant revenue	**840,833**	762,916
Total liabilities	**991,538**	907,449
Net assets:		
Unrestricted	**533,515**	730,966
Restricted	**490,357**	314,718
Total liabilities and net assets	**$ 2,015,410**	$ 1,953,133

See notes to financial statements

Health Care Incentives Improvement Institute, Inc.
Statements of Activities
for the years ended December 31,

	2012	2011
Unrestricted Net Assets		
Unrestricted revenue and gains:		
License fees	$ 1,057,084	$ 1,173,125
Grants and contracts	603,793	207,539
Operational fees	195,000	505,638
Investment income	58,811	33,087
Recognized change in fair value of investments	73,566	(29,080)
Honorarium, physician portal and other income	17,730	12,318
Net assets released from restrictions	1,048,116	884,624
Total unrestricted revenue and gains	3,054,100	2,787,251
Expenses:		
Program services	2,579,439	2,039,446
Supporting services	672,112	818,521
Total expenses	3,251,551	2,857,967
Change in unrestricted net assets	(197,451)	(70,716)
Temporarily Restricted Net Assets		
Grants and contracts	1,223,755	1,186,017
Net assets released from restrictions	(1,048,116)	(884,624)
Change in temporarily restricted net assets	175,639	301,393
Change in net assets	(21,812)	230,677
Unrestricted net assets, beginning of year	1,045,684	815,007
Unrestricted net assets, end of year	$ 1,023,872	$ 1,045,684

See notes to financial statements

Health Care Incentives Improvement Institute, Inc.
Statements of Cash Flows
Representing Increases (Decreases) in Cash
for the years ended December 31,

	2012	2011
Cash flows from operating activities:		
Increase (decrease) in unrestricted net assets	$ (21,812)	$ 230,677
Depreciation	22,732	19,131
Unrealized (gain) loss on investments	(73,566)	29,080
Loss from asset disposal	427	-
Bad debt write-off	-	142,548
Changes in operating assets and liabilities:		
Accounts receivable	50,042	(56,641)
Grants and contracts receivable	(238,113)	230,674
Accounts payable and accrued expenses	6,172	22,761
Deferred revenue	77,917	(118,126)
Net cash provided by operating activities	(176,201)	500,104
Cash flows from investing activities:		
Net cash proceeds from sale of investments	150,000	-
Purchase of investments	-	(1,050,000)
Investment gains and earnings reinvested	(58,811)	(33,087)
Capital additions	(10,893)	(23,704)
Net cash used in investing activities	80,296	(1,106,791)
Net decrease in cash	(95,905)	(606,687)
Cash and cash equivalents, beginning of year	415,675	1,022,362
Cash and cash equivalents, end of year	$ 319,770	$ 415,675

See notes to financial statements

1. **Summary of Significant Accounting Policies**

Nature of Activities

Health Care Incentives Improvement Institute, Inc. ("HCI3"), is a tax-exempt (501(c)(3)), nonprofit organization that designs and creates programs that encourage physicians and physician practices to deliver safer, more effective and efficient care to patients with certain chronic conditions by giving them financial and other incentives to do so. HCI3 works with purchasers, including health plans and providers across the country, to create the mechanisms to improve the health care system. HCI3 programs provide purchasers and their employees with the information they need to make better health care decisions and obtain cost effective care. Thousands of physicians throughout the country participate in HCI3's programs, including *The Physician Office Link, Diabetes Care Link, Cardiac Care Link, Spine Care Link and HCI3 Medical Home Programs*.

HCI3 operates a health care services payment model ("Prometheus Engine") designed to incorporate payment incentives tied to efficiency and quality of care metrics based on Evidence-informed Case Rates ("ECR's"). Under this system, participating providers are measured against an ECR comprehensive scorecard that provides individual performance measures. Performance bonuses are paid to providers whose care exceeds established performance thresholds. The objective is to improve effectiveness and efficiency of care by holding providers responsible for the cost and quality of services delivered to the patient. The system is designed to create a patient-centered delivery system and activate consumers through quality of care and pricing information on providers.

Trade Accounts Receivable

Trade accounts receivable are carried at their estimated collectible amounts. Trade credit is generally extended on a short-term basis thus trade receivables do not bear interest. Trade receivables are periodically evaluated for collectability and charged off when they are deemed to be uncollectible.

Property and Equipment

Property and equipment are stated at cost and consist principally of capitalized software and computer equipment. Depreciation is provided using the straight line method over estimated useful lives which range from 3 to 5 years. Accumulated depreciation at December 31, 2012 and 2011 was $289,226 and $283, 233, respectively. It is HCI3's policy to capitalize expenditures for software and equipment that cost in excess of $500.

1. Summary of Significant Accounting Policies (continued)

Software Development Costs

Development costs of computer software to be sold, leased, or otherwise marketed are subject to capitalization beginning when the software's technological feasibility has been established and ending when the software is available for general release to customers pursuant to Accounting Standards Codification 985-385-20, "Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed." Technological feasibility is attained when a working model of the software has been completed whose consistency with the overall product design has been confirmed by testing. Costs incurred prior to the establishment of technological feasibility are expensed as incurred. Upon general release of the software product to customers, capitalization ceases and such costs are amortized over a five year period on a straight-line basis. Maintenance related costs are expensed as incurred. In most instances the Organization's software products are released soon after technological feasibility has been established. Therefore costs incurred after technological feasibility are not significant and generally most software development costs are expensed. There were no software development costs capitalized during 2012 and 2011.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents consist of bank accounts and all highly liquid investments purchased with a maturity of three months or less.

Concentration Risks

At certain times, the Organization has amounts on deposit with financial institutions in excess of the FDIC insured limit. The Organization has not experienced any loses in such accounts and believes it is not exposed to any significant credit risk on cash and cash equivalents. As of December 31, 2012 and 2011, the aggregate cash balances at a financial institution used by HCI3 exceeded the federally insured limit of $250,000 by $69,770 and $165,675, respectively.

Revenue Recognition

Recognition of revenues from licenses are deferred and recognized ratably over the period to which the license applies. Recognition of revenues from grants are recognized as the conditions of the grants are met. Revenue from operational fees, physician portal and other income is recognized as earned.

1. Summary of Significant Accounting Policies (continued)

Fair Value Measurements

The carrying values of current assets and liabilities approximate fair value due to the short-term maturities of these assets and liabilities.

Investments and Investment Income

Investments with readily determinable fair values are measured at fair value in the statements of financial position. Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in the excess of revenue and other support over expenses unless the income or loss is restricted by donor or law.

Net Assets

Grants are considered to be available for unrestricted use unless specifically restricted by the donor. Amounts received that are designated for future periods or restricted by the Grantor for specific purposes are reported as temporarily restricted or permanently restricted support that increases those net asset classes. When a temporary restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

Functional Allocation of Expenses

The costs of providing programs and activities have been summarized on a functional basis in the Statement of Activities. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Program services consist of activities related to licensing and implementation support of HCI3 programs to health plans throughout the country, development of ECR data bases, and planning, development, implementation, and operation of the Prometheus Engine.

Supporting services consist of general and administrative expenses.

Income Taxes

Management annually evaluates all federal and state income tax positions. This process includes an analysis of whether these income tax positions meet the definition of an uncertain tax position under the Income Taxes Topic of the Financial Accounting Standards Codification. In general, HCI3 is no longer subject to tax examinations for the tax years ending before December 31, 2009.

1. Summary of Significant Accounting Policies (continued)

Subsequent Events

The Organization evaluated the effect subsequent events would have on the financial statements through April 19, 2013, which is the date the financial statements were available to be issued.

Reclassification

Certain items in the 2011 financial statements have been reclassified to conform with 2012 reporting.

2. Fair Value Measurements

The Organization has established a framework for measuring fair value, based on a fair value hierarchy that is intended to increase consistency and comparability in fair value measurements and related disclosures.

This hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three levels, as follows:

- Level 1 – Inputs to the valuation methodology based on unadjusted quoted market prices in active markets that are accessible at the measurement date.
- Level 2 – Inputs to the valuation methodology that include quoted market prices that are not considered to be active or financial instruments for which all significant inputs are observable, either directly or indirectly.
- Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

At December 31, 2012, HCI3's investments consisted of Level 1 investments of holdings in Fidelity Investments Blended Funds.

The Organization's investment securities are subject to exposure to various risks such as interest rate risk, financial market risk, and credit risk. Due to the level of risk associated with investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the value of investment securities reported in the Organization's financial statements.

3. Employee Benefit Plan

HCI3 maintains a defined contribution savings plan, qualified under Section 403(b) of the Internal Revenue Code that covers substantially all of its full-time employees. The savings plan allows employees to defer up to 15% of their salary, with the Organization partially matching employee contributions and covering certain administrative expenses of the savings plan. The Organization contributed $45,115 and $34,043 to the Plan during the years ended December 31, 2012 and 2011, respectively.