HEALTH CARE INCENTIVES IMPROVEMENT INSTITUTE, INC.

Financial Statements

for the years ended December 31, 2013 and 2012

Actis-Grande, Ronan & Company, LLC
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

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

Report on the Financial Statements

We have audited the accompanying statements of financial position of Health Care Incentives Improvement Institute, Inc. (a nonprofit organization) as of December 31, 2013 and 2012, and the related statements of activities, and cash flows for the years then ended and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

The Organization's 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 audits. We conducted our audits in accordance with auditing standards generally accepted in the United State 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 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 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 the accounting principles 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 Health Care Incentives Improvement Institute, Inc. as of December 31, 2013 and 2012 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.

April 4, 2014

Actis-Grande, Ronan & Company, LLC

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

		2013		2012
Assets				
Cash and cash equivalents	$	**304,768**	$	319,770
Accounts receivable		**300,000**		375,000
Grants and contracts receivable		**188,354**		255,423
Investments		**1,202,313**		1,036,384
Prepaid expenses		**10,000**		-
Property and equipment, net of accumulated depreciation		**33,360**		28,833
Total assets	$	**2,038,795**	$	2,015,410
Liabilities and Net Assets				
Accounts payable and accrued expenses	$	**231,489**	$	150,705
Deferred license and grant revenue		**730,208**		840,833
Total liabilities		**961,697**		991,538
Net assets:				
Unrestricted		**564,564**		533,515
Restricted		**512,534**		490,357
Total liabilities and net assets	$	**2,038,795**	$	2,015,410

See notes to financial statements

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

	2013	2012
Unrestricted Net Assets		
Unrestricted revenue and gains:		
License fees	$ 995,625	$ 1,057,084
Grants and contracts	640,184	603,793
Operational fees	225,000	195,000
Investment income	66,678	58,811
Recognized change in fair value of investments	137,250	73,566
Honorarium, physician portal and other income	44,749	17,730
Net assets released from restrictions	1,077,823	1,048,116
Total unrestricted revenue and gains	3,187,309	3,054,100
Expenses:		
Program services	2,232,648	2,579,439
Supporting services	923,612	672,112
Total expenses	3,156,260	3,251,551
Change in unrestricted net assets	31,049	(197,451)
Temporarily Restricted Net Assets		
Grants and contracts	1,100,000	1,223,755
Net assets released from restrictions	(1,077,823)	(1,048,116)
Change in temporarily restricted net assets	22,177	175,639
Change in net assets	53,226	(21,812)
Unrestricted net assets, beginning of year	1,023,872	1,045,684
Unrestricted net assets, end of year	$ 1,077,098	$ 1,023,872

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,

	2013	2012
Cash flows from operating activities:		
Increase (decrease) in unrestricted net assets	$ 53,226	$ (21,812)
Depreciation	23,552	22,732
Unrealized (gain) loss on investments	(137,250)	(73,566)
Loss from asset disposal	-	427
Changes in operating assets and liabilities:		
Accounts receivable	75,000	50,042
Grants and contracts receivable	67,069	(238,113)
Prepaid expenses	(10,000)	-
Accounts payable and accrued expenses	80,784	6,172
Deferred revenue	(110,625)	77,917
Net cash provided by (used in) operating activities	41,756	(176,201)
Cash flows from investing activities:		
Net cash proceeds from sale of investments	38,000	150,000
Investment gains and earnings reinvested	(66,679)	(58,811)
Capital additions	(28,079)	(10,893)
Net cash (used in) provided by investing activities	(56,758)	80,296
Net decrease in cash	(15,002)	(95,905)
Cash and cash equivalents, beginning of year	319,770	415,675
Cash and cash equivalents, end of year	$ 304,768	$ 319,770

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, 2013 and 2012 was $312,778 and $289, 226, 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 2013 and 2012.

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 cash in bank accounts which are principally maintained at one financial institution. Accounts maintained at commercial banks are insured by the Federal Deposit Insurance Corporation ("FDIC") for up to $250,000 per financial institution. At times throughout the year, the account balances may exceed the FDIC insured limits.

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, 2013 and 2012, the aggregate cash balances at a financial institution used by HCI3 exceeded the federally insured limit of $250,000 by $54,768 and $69,770, 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, 2010.

Subsequent Events:

The Organization evaluated the effect subsequent events would have on the financial statements through April 4, 2014, which is the date the financial statements were available to be issued.

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, 2013 and 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 $49,533 and $45,115 to the Plan during the years ended December 31, 2013 and 2012, respectively.