



## REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors  
Kansas Health Foundation

We have audited the accompanying balance sheets of Kansas Health Foundation as of December 31, 2007 and 2006, and the related statements of activity and cash flows for the years then ended. These financial statements are the responsibility of the Foundation'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 as established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Foundation's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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, financial statements referred to above present fairly, in all material respects, the financial position of Kansas Health Foundation as of December 31, 2007 and 2006, 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.

*Grant Thornton LLP*

Wichita, Kansas  
June 20, 2008

**KANSAS HEALTH FOUNDATION**  
**Balance Sheets**  
**December 31, 2007 and 2006**

	<b>2007</b>	<b>2006</b>
<b>Assets</b>		
Cash and cash equivalents	\$ 7,277,549	7,566,860
Investments (Note 3)	528,100,516	514,427,010
Accrued interest and dividends receivable	417,352	532,947
Due from brokers	241,458	76,773
Excise taxes receivable (Note 8)	206,445	321,103
Property and equipment, net (Note 4)	4,004,176	4,025,602
Other assets	<u>932,908</u>	<u>818,874</u>
	<u>\$ 541,180,404</u>	<u>527,769,169</u>
 <b>Liabilities and Net Assets</b>		
Due to brokers	\$ 618,630	264,733
Accounts payable	89,617	65,800
Grants payable (Note 7)	22,467,794	26,556,967
Accrued expenses	753,329	313,862
Deferred excise taxes payable (Note 8)	<u>2,213,467</u>	<u>2,276,667</u>
Total liabilities	<u>26,142,837</u>	<u>29,478,029</u>
Net assets	<u>515,037,567</u>	<u>498,291,140</u>
	<u>\$ 541,180,404</u>	<u>527,769,169</u>

**Commitments (Note 10)**

See accompanying notes to financial statements.

**KANSAS HEALTH FOUNDATION**  
**Statements of Activity**  
**Years Ended December 31, 2007 and 2006**

	<b>2007</b>	<b>2006</b>
<b>Revenues and gains (losses):</b>		
Investment income (Note 3)	\$ 16,063,251	13,805,954
Net realized and unrealized gains on investments (Note 3)	26,335,548	57,424,814
Investment expenses	(1,611,785)	(1,428,243)
Other income (Note 9)	<u>352,080</u>	<u>232,849</u>
<b>Total revenues and gains</b>	<u>41,139,094</u>	<u>70,035,374</u>
<b>Program grants, net (Note 7)</b>	<u>19,251,802</u>	<u>39,307,519</u>
<b>Operating expenses (Note 6):</b>		
Compensation and benefits	3,095,161	2,581,058
Professional and contractual services	632,280	429,543
Depreciation	269,716	289,067
Other	<u>692,250</u>	<u>831,138</u>
<b>Total operating expenses</b>	<u>4,689,407</u>	<u>4,130,806</u>
<b>Increase in net assets before excise taxes</b>	17,197,885	26,597,049
<b>Excise taxes (Note 8)</b>	<u>451,458</u>	<u>989,222</u>
<b>Increase in net assets</b>	16,746,427	25,607,827
<b>Net assets, beginning of year</b>	<u>498,291,140</u>	<u>472,683,313</u>
<b>Net assets, end of year</b>	<u>\$ 515,037,567</u>	<u>498,291,140</u>

See accompanying notes to financial statements.

**KANSAS HEALTH FOUNDATION**  
**Statements of Cash Flows**  
**Years Ended December 31, 2007 and 2006**

	<b>2007</b>	<b>2006</b>
<b>Cash flows from operating activities:</b>		
Increase in net assets	\$ 16,746,427	25,607,827
Adjustments to reconcile increase in net assets to net cash used in operating activities:		
Depreciation	269,716	289,067
Net loss on disposition of equipment	309	44,904
Decrease in accrued interest and and dividends receivable	115,595	227,148
Decrease (increase) in excise taxes receivable	114,658	(10,036)
Increase in other assets	(114,034)	(194,552)
Increase (decrease) in accounts payable	23,817	(28,961)
(Decrease) increase in grants payable	(4,089,173)	18,675,581
Increase (decrease) in accrued expenses	439,467	(2,097)
(Decrease) increase in deferred excise taxes	(63,200)	649,259
Net realized and unrealized gains on investments	<u>(26,335,548)</u>	<u>(57,424,814)</u>
<b>Net cash used in operating activities</b>	<u>(12,891,966)</u>	<u>(12,166,674)</u>
<b>Cash flows from investing activities:</b>		
Additions to property and equipment	(249,174)	(328,468)
Proceeds from sale of equipment	575	41,894
Proceeds from sale of investments	96,216,961	94,668,393
Purchase of investments	(83,554,919)	(83,593,258)
(Increase) decrease in due from brokers	(164,685)	256,637
Increase in due to brokers	<u>353,897</u>	<u>121,317</u>
<b>Net cash provided by investing activities</b>	<u>12,602,655</u>	<u>11,166,515</u>
<b>Net decrease in cash and cash equivalents</b>	(289,311)	(1,000,159)
<b>Cash and cash equivalents, beginning of year</b>	<u>7,566,860</u>	<u>8,567,019</u>
<b>Cash and cash equivalents, end of year</b>	<u>\$ 7,277,549</u>	<u>7,566,860</u>

4 See accompanying notes to financial statements.

**KANSAS HEALTH FOUNDATION**  
**Notes to Financial Statements**  
**December 31, 2007 and 2006**

**(1) Organization and Operations**

The mission of Kansas Health Foundation (Foundation) is to improve the health of all Kansans. The Foundation qualifies as an organization exempt from federal income tax pursuant to Internal Revenue Code (Code) Section 501(c)(3) and as a private foundation within the meaning of Code Section 509(a) under a determination letter received from the Internal Revenue Service dated December 29, 1993.

**(2) Summary of Significant Accounting Policies**

**(a) Basis of Accounting**

The accompanying financial statements are prepared on the accrual basis. Revenue is recognized when earned and expenses are recognized upon receipt of goods or services.

**(b) Investments**

Investments in equity securities, equity mutual funds and real estate investment trusts with readily determinable fair values, and all fixed income investments, are reported at fair value on a trade date basis. Fair value is based on quoted market prices in active markets. Both realized and unrealized gains and losses are included in the statements of activity.

Marketable alternative equities, which include investments commonly known as hedge funds, are reported at net asset value per share, which is considered fair value, as determined on a monthly basis by the funds' investment managers.

Non-marketable investments consist of partnership interests in private equity, venture capital, private real estate and natural resources limited partnerships. Fair value for these investments is determined by each partnerships' general partner, based on the estimated fair value of the underlying partnership assets. One non-marketable partnership investment where fair value is not readily determinable is reported at cost of \$3,540,000, as the Foundation does not have significant influence over the operating and financial policies of the partnership.

**(c) Cash Equivalents**

Cash equivalents represent short-term investments with original maturities of three months or less.

**(d) Property and Equipment**

Property and equipment are recorded at cost. Depreciation is being provided on depreciable assets over the estimated useful lives of the respective assets on the straight-line basis.

**KANSAS HEALTH FOUNDATION**  
**Notes to Financial Statements**  
**December 31, 2007 and 2006**

**(2) Summary of Significant Accounting Policies (continued)**

**(e) Program Grants**

Program grants are recorded in the accompanying financial statements when the Foundation has an obligation to transfer assets to a grantee, normally when a grant contract is executed. Grants are recorded based on the present value of estimated future cash flows, discounted at an average annual market rate of interest in the year of approval.

**(f) Use of Estimates**

Foundation management has made estimates and assumptions relating to the reporting of assets and liabilities, and the disclosure of contingent assets and liabilities, in preparing these financial statements in conformity with accounting principles generally accepted in the United States of America. Estimates also affect the reported amounts of revenues, gains, program grants and operating expenses during the reporting period. Actual results could differ from these estimates.

**(g) Fair Value of Financial Instruments**

Statement of Financial Accounting Standards No. 107, "Disclosure About Fair Value of Financial Instruments", requires that the Foundation disclose estimated fair values for its financial instruments. The carrying values of the Foundation's financial instruments approximate their fair value.

**(3) Investments**

**(a) Investment Objective**

The Foundation's long-term financial objectives are to preserve and enhance the inflation adjusted value of its assets in perpetuity and provide a relatively stable stream of earnings consistent with spending needs. These financial objectives are intended to balance the needs of current and future generations of the Foundation's beneficiaries. The primary long-term investment objective of the Foundation is to earn an average annual inflation adjusted total return of at least 5%, net of all investment management fees, operating expenses and taxes over a long-term (rolling ten-year periods).

**KANSAS HEALTH FOUNDATION**  
**Notes to Financial Statements**  
**December 31, 2007 and 2006**

**(3) Investments (continued)**

**(b) Composition of Investments**

Investments presented in the accompanying financial statements are composed of the following:

		<b>December 31, 2007</b>	
		Cost	Fair Value
Equity securities and mutual funds	\$	196,156,804	280,101,452
Marketable alternative equities		54,494,887	74,503,588
Real estate investment trusts		19,285,668	23,275,965
Non-marketable investments		19,698,617	20,125,433
Fixed income mutual funds		100,957,377	100,930,624
U.S. Treasury obligations		26,988,048	29,163,454
		\$ 417,581,401	528,100,516

		<b>December 31, 2006</b>	
		Cost	Fair Value
Equity securities and mutual funds	\$	205,234,780	289,076,716
Marketable alternative equities		52,046,892	68,261,327
Real estate investment trusts		15,646,194	32,290,804
Non-marketable investments		9,064,946	9,108,475
Fixed income mutual funds		92,541,901	89,102,651
Federal agency obligations		3,757,000	3,757,000
U.S. Treasury obligations		22,301,965	22,830,037
		\$ 400,593,678	514,427,010

**(c) Components of Investment Return**

The components of investment return in the statements of activity are as follows:

		<b>2007</b>	<b>2006</b>
Interest and dividends	\$	16,063,251	13,805,954
Realized gains and losses		29,649,765	24,961,898
Unrealized gains and losses		(3,314,217)	32,462,916
		\$ 42,398,799	71,230,768

**KANSAS HEALTH FOUNDATION**  
**Notes to Financial Statements**  
**December 31, 2007 and 2006**

**(4) Property and Equipment**

A summary of property and equipment follows:

	<b>2007</b>	<b>2006</b>
Land	\$ 953,428	953,428
Building and Improvements	4,038,147	3,923,457
Equipment, furniture and fixtures	<u>1,705,309</u>	<u>1,580,958</u>
	6,696,884	6,457,843
Less accumulated depreciation	<u>(2,692,708)</u>	<u>(2,432,241)</u>
Property and equipment, net	<u>\$ 4,004,176</u>	<u>4,025,602</u>

Depreciation is provided on the straight-line basis over the following useful lives:

Building and improvements	3-40 years
Equipment, furniture and fixtures	3-10 years

**(5) Employees' Retirement Plans**

The Foundation provides retirement benefits to its employees through two defined contribution pension plans. All employees are eligible to participate in the plans immediately on employment. The Foundation contributed \$253,208 and \$242,182 to the plans in 2007 and 2006, respectively. The Foundation's policy is to fund pension costs as accrued and no prior service costs exist under the plans. Employees may contribute additional amounts to the plans. Employer and employee contributions are fully vested when the employee becomes eligible for participation.

**(6) Functional Classification of Operating Expenses**

The Foundation's operating expenses for 2007 and 2006 are allocated among the following functions on the basis of staff time incurred and office space utilization:

	<b>2007</b>	<b>2006</b>
Program activities	\$ 3,753,406	3,216,908
Investment activities	803,647	789,612
Management and general	<u>132,354</u>	<u>124,286</u>
	<u>\$ 4,689,407</u>	<u>4,130,806</u>

**KANSAS HEALTH FOUNDATION  
Notes to Financial Statements  
December 31, 2007 and 2006**

**(7) Grants Payable and Program Grants**

As discussed in note 2(e), program grants are recorded on a discounted present value basis. At December 31, 2007 and 2006, the grant contracts and discount were as follows:

	2007	2006
Grant contracts	\$ 29,449,903	34,110,701
Discount	<u>(6,982,109)</u>	<u>(7,553,734)</u>
Grants payable	<u>\$ 22,467,794</u>	<u>26,556,967</u>

In addition to grants payable recorded in the financial statements, the Foundation's Board of Directors has authorized funding for future grants for certain of its program areas. Authorized grants are not recorded as grants payable and program grants in the financial statements since grant contracts have not been executed. Management's best estimate of when the total of grant contracts and authorized grants as of December 31, 2007 will be paid is as follows:

	Grant Contracts	Authorized Grants
2008	\$ 5,545,179	\$ 3,268,518
2009	5,095,182	5,532,356
2010	3,574,000	8,206,724
2011	3,235,542	6,838,273
2012	3,000,000	5,380,000
2013-2020	<u>9,000,000</u>	<u>39,009,527</u>
	<u>\$ 29,449,903</u>	<u>\$ 68,235,398</u>

Included in December 31, 2007 grant contracts is \$24 million, estimated to be payable at about \$3 million per year through 2015, for core operations of the Kansas Health Institute (KHI), a non-profit, tax exempt corporation located in Topeka, Kansas. KHI was created by the Foundation in 1994 as a health policy and research institute for Kansas. Approximately \$24 million in core grants have previously been paid to KHI, as well as other project specific grants. These grants constitute a substantial portion of KHI revenue from its inception through 2007.

Included in December 31, 2007 grant contracts and authorized grants is \$2.45 million and \$23.5 million, respectively, estimated to be payable at about \$2 million per year through 2020, for core operations of a separate non-profit, tax exempt corporation, the Kansas Leadership Center (KLC). KLC was created by the Foundation in 2006 and began operations in Wichita, Kansas in 2007. KLC's mission is to enhance existing leadership programs and develop new leadership initiatives in Kansas. During 2007 the Foundation made grant payments of \$4,050,000 and also advanced operating funds to KLC. As of December 31, 2007, KLC owed the Foundation \$72,024, which is included in other assets on the accompanying balance sheet.

**KANSAS HEALTH FOUNDATION**  
**Notes to Financial Statements**  
**December 31, 2007 and 2006**

**(7) Grants Payable and Program Grants, continued**

Program grants in the statements of activity are reported net of grant amounts refunded and grant contracts written off.

**(8) Excise and Income Taxes**

The Foundation is exempt from Federal income taxes under Section 501(a) of the Internal Revenue Code of 1986, as amended, as an organization described in Section 501(c)(3). Accordingly, the Foundation is not subject to Federal income tax, except to the extent that it has unrelated business taxable income. In the opinion of management, the Foundation did not have material unrelated business taxable income in 2007. The Foundation reported a taxable loss of \$15,480 on its 2006 Federal income tax return, which is available to offset future taxable income. No provision for Federal income taxes is recorded in the accompanying financial statements.

The Foundation is classified as a private foundation under Section 509(a) and, as such, is subject to a Federal excise tax of 2% on net investment income, unless certain conditions are met, in which case the Federal excise tax is reduced to 1%. In 2007 and 2006, the Foundation was subject to an excise tax on net investment income of 1%. Taxes receivable in the accompanying balance sheets represent refunds due on federal excise taxes paid in excess of the related excise tax expense as of December 31, 2007 and 2006 respectively. The Foundation made estimated excise tax payments of \$400,000 in 2007 and \$350,000 in 2006.

Deferred excise taxes are provided for on the unrealized increase in the fair value of the Foundation's investment assets at a 2% rate. Deferred excise taxes payable was \$2,213,467 and \$2,276,667 at December 31, 2007 and 2006, respectively. Excise tax expense consists of the following:

	<b>2007</b>	<b>2006</b>
Current excise tax expense	\$ 514,658	339,964
Deferred excise tax expense (benefit)	<u>(63,200)</u>	<u>649,258</u>
Total excise tax expense	<u>\$ 451,458</u>	<u>989,222</u>

The Foundation is also required to make certain minimum qualifying distributions of its assets for charitable purposes in accordance with formulas provided by Federal law. The Foundation has complied with such requirements.

**KANSAS HEALTH FOUNDATION**  
**Notes to Financial Statements**  
**December 31, 2007 and 2006**

**(9) Land Lease**

The Foundation, as lessor, has leased certain land (cost-\$366,155) under a long-term operating lease which expires in the year 2081. Future rentals to be received under the lease are as follows:

2008	\$	107,140
2009		107,140
2010		107,140
2011		107,140
2012		107,140
2013-2081		<u>7,393,316</u>
	\$	<u><u>7,929,016</u></u>

**(10) Commitments**

As of December 31, 2007 the Foundation had made commitments totaling approximately \$42,980,000 under investment management agreements to fund certain real estate, natural resources and other non-marketable investments as managers request the funds.

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