

North Carolina Medical Society

Audited Consolidated Financial Statements and Other Financial Information

*Years ended December 31, 2016 and 2015
with Report of Independent Auditors*

North Carolina Medical Society

Audited Consolidated Financial Statements and Other Financial Information

Years ended December 31, 2016 and 2015

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Report of Independent Auditors

Board of Directors
North Carolina Medical Society

We have audited the accompanying consolidated financial statements of North Carolina Medical Society (the Society), which comprise the consolidated statements of financial position as of December 31, 2016 and 2015, and the related consolidated statements of activities and cash flows for the years then ended and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over financial reporting. 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the North Carolina Medical Society as of December 31, 2016 and 2015, and the consolidated changes in their net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Report of Independent Auditors (continued)

Other Matter

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying schedules as of and for the years ended December 31, 2016 and 2015 on pages 16 through 23 are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information, except that marked unaudited, has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information as of and for the years ending December 31, 2016 and 2015 is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

A handwritten signature in cursive script that reads "Johnson Lambert LLP". The signature is written in black ink and is positioned above the typed name and date.

Raleigh, North Carolina
August 22, 2017

North Carolina Medical Society

Consolidated Statements of Financial Position

As of December 31, 2016 and 2015

Assets	2016	2015
Current assets		
Cash and cash equivalents	\$ 1,491,223	\$ 1,352,875
Accounts receivable	482,913	88,192
Due from affiliates	-	390,540
Prepaid expenses	50,752	43,904
Total current assets	2,024,888	1,875,511
Marketable securities	8,331,020	8,879,575
Property and equipment:		
Land and improvements	490,245	490,245
Buildings and improvements	7,733,080	7,634,309
Vehicles	52,242	52,242
Furniture, fixtures and equipment	1,097,037	1,097,037
	9,372,604	9,273,833
Less accumulated depreciation	3,810,725	3,397,509
Property and equipment, net	5,561,879	5,876,324
Total assets	\$ 15,917,787	\$ 16,631,410

Continued

North Carolina Medical Society

Consolidated Statements of Financial Position - Continued

As of December 31, 2016 and 2015

Liabilities and net assets	2016	2015
Current liabilities		
Accounts payable and accrued expenses	\$ 219,727	\$ 240,104
Pledges payable	-	5,000
Accrued payroll and related liabilities:		
Salaries and wages	224,530	190,131
Deferred compensation - current	-	67,500
Other	1,500	35,543
Agency obligations	102,126	142,609
Refundable dues	14,050	9,227
Deferred membership dues	1,417,043	1,561,902
Loans payable - current	416,187	404,241
Total current liabilities	2,395,163	2,656,257
Noncurrent liabilities:		
Deferred compensation - noncurrent	131,428	77,143
Loans payable - noncurrent	332,723	638,883
Total liabilities	2,859,314	3,372,283
Net assets		
Unrestricted:		
Designated by the Board of Directors for:		
Operating reserve	1,000,000	1,000,000
Property and equipment replacements	3,397,509	3,397,509
Physician and patient advocacy and protection reserve	791,372	791,372
Undesignated	7,848,073	7,958,095
Total unrestricted	13,036,954	13,146,976
Temporarily restricted	21,519	112,151
Total net assets	13,058,473	13,259,127
Total liabilities and net assets	\$ 15,917,787	\$ 16,631,410

See accompanying notes to the consolidated financial statements.

North Carolina Medical Society

Consolidated Statements of Activities

For the years ended December 31, 2016 and 2015

Changes in unrestricted net assets	2016	2015
Revenues and gains		
Membership dues	\$ 2,697,615	\$ 2,878,048
Investment income:		
Net realized and unrealized gains (losses)	500,732	(549,304)
Interest and dividends	169,729	222,634
Product service endorsements	1,068,513	1,054,870
Rental income	246,781	158,912
Specialty and county society services	373,085	383,523
Contributions - building	239,778	352,494
Other	305,124	171,526
Net assets released from restrictions	171,926	30,000
Total revenues and gains	5,773,283	4,702,703
Expenses and losses		
Programs	4,221,941	3,299,697
Supporting services:		
Membership development	613,412	604,803
General and administrative	1,027,952	1,119,003
Total expenses	5,863,305	5,023,503
Loss on disposal of property and equipment	-	3,104
Total expenses and losses	5,863,305	5,026,607
Transfer to temporarily restricted net assets	20,000	-
Changes in unrestricted net assets	(110,022)	(323,904)
Changes in temporarily restricted net assets		
Contributions	61,250	64,151
Interest	44	52
Net assets released from restrictions	(171,926)	(30,000)
Transfer from unrestricted net assets	20,000	-
Changes in temporarily restricted net assets	(90,632)	34,203
Changes in net assets	(200,654)	(289,701)
Net assets, beginning of year	13,259,127	13,548,828
Net assets, end of year	\$ 13,058,473	\$ 13,259,127

See accompanying notes to the consolidated financial statements.

North Carolina Medical Society

Consolidated Statements of Cash Flows

For the years ended December 31, 2016 and 2015

	2016	2015
Cash flows from operating activities		
Changes in net assets	\$ (200,654)	\$ (289,701)
Adjustments to reconcile changes in net assets to net cash provided by operating activities		
Net realized and unrealized (gains) losses on marketable securities	(500,732)	549,304
Depreciation	413,216	439,926
Loss on disposal of property and equipment	-	3,104
Changes in assets and liabilities		
Accounts receivable	(394,722)	396,532
Due from affiliates	390,540	25,978
Prepaid expenses	(6,848)	8,258
Accounts payable and accrued expenses	(20,377)	(16,016)
Pledge payable	(5,000)	(10,000)
Accrued payroll and related liabilities	356	35,496
Agency obligations	(40,483)	35,461
Refundable dues	4,823	4,457
Deferred membership dues	(144,859)	(228,390)
Deferred compensation	(13,215)	(714)
Net cash (used in) provided by operating activities	(517,955)	953,695
Cash flows from investing activities		
Proceeds from sales of marketable securities	2,540,583	2,811,085
Purchases of marketable securities	(1,491,295)	(2,390,880)
Capital expenditures	(98,771)	(404,169)
Net cash provided by investing activities	950,517	16,036
Cash flows from financing activities		
Borrowings under loan	171,632	-
Payments on bank loan	(465,846)	(675,350)
Net cash used in financing activities	(294,214)	(675,350)
Net decrease in cash and cash equivalents	138,348	294,381
Cash and cash equivalents, beginning of year	1,352,875	1,058,494
Cash and cash equivalents, end of year	\$ 1,491,223	\$ 1,352,875
Supplemental disclosures of cash payments for		
Interest	\$ 21,820	\$ 36,231
Taxes	\$ 60	\$ 158

See accompanying notes to the consolidated financial statements.

North Carolina Medical Society

Notes to Consolidated Financial Statements

Years ended December 31, 2016 and 2015

Note A - Organization and Summary of Significant Accounting Policies

Organization

The Medical Society of the State of North Carolina was incorporated by the General Assembly of North Carolina on April 16, 1849. On July 6, 1972, its name was changed to North Carolina Medical Society (NCMS). NCMS is recognized as a tax-exempt organization under Internal Revenue Code 501(c)(6). The purpose of NCMS is to organize members of the medical profession to advance medical science and elevate standards of medical education and service.

On May 19, 2016, NCMS incorporated Carolina Complete Health Network (CCHN), formerly known as Formation Subsidiary, Inc., for the purpose of establishing, building and maintaining a physician-led network of providers to serve Medicaid beneficiaries in North Carolina.

On January 10, 2017, NCMS, working in conjunction with the North Carolina Community Health Center Association (NCCHCA), announced CCHN had signed a definitive agreement with Centene Corporation (NYSE: CNC) to collaborate on a patient-focused approach to Medicaid under the reform plan enacted in the State of North Carolina. Under the agreement, a joint venture, Carolina Complete Health, will be created to establish, organize and operate a physician-led health plan to provide Medicaid managed care services in North Carolina. CCHN will furnish provider network services to Carolina Complete Health, to serve Medicaid beneficiaries with value-based models-of-care.

A key feature of the joint venture will be the active participation of physicians in the ownership and governance of the health plan. Centene will manage the financial and daily operations, while the CCHN, which will be owned jointly by NCMS, physicians, physician assistants, nurse practitioners and Federally Qualified Health Centers, will provide medical management services, hold a majority on the Board of Directors and oversee the medical policies for the health plan. This partnership seeks to engage all North Carolina physicians including those in primary care specialties like pediatrics, family medicine and obstetrics and gynecology as well as hospital-based physicians and the wide diversity of specialties and sub-specialties necessary to serve the Medicaid population of the state. We view all of these groups as significant contributors to the success of this endeavor.

NCMS and CCHN are "testing the waters" under Regulation A under the Securities Act of 1933, as amended, to gauge market demand from potential investors for an offering of CCHN's securities.

NCMS currently owns 100% of the common stock of CCHN, having a par value of \$1.

The North Carolina Medical Society Political Education and Action Committee (the NCMS PAC) is a segregated fund as defined under Section 527(f) of the Internal Revenue Code. The NCMS PAC was created pursuant to the Federal Election Campaign Act and is regulated by the Federal Election Commission. The NCMS PAC represents over 12,500 physicians, physician assistants, residents, and medical students.

Citizens for a Healthy North Carolina (CHNC) is a segregated fund as defined under Section 527(f) of the Internal Revenue Code. This is an independent expenditure committee created pursuant to Article 22A, 22B and 22D-M of Chapter 163 of the North Carolina General Statutes.

North Carolina Medical Society

Notes to Consolidated Financial Statements (Continued)

Note A - Organization and Summary of Significant Accounting Policies (continued)

Organization (continued)

NCMS's programs, in accordance with its Strategic Plan, include member advocacy, legislation and regulation, health policy and research, member benefits and services, specialty society relations, managed care and practice management, AMA delegation, education, quality, access and healthcare reform initiatives, professional liability reform and support of affiliated organizations such as The North Carolina Medical Society Foundation (the Foundation) and the North Carolina Physicians Health Program.

Basis of Consolidation

The consolidated financial statements include the accounts of NCMS, CCHN, the NCMS PAC, and CHNC (collectively the Society). All significant intercompany transactions and balances have been eliminated in consolidation.

Basis of Presentation

The accompanying consolidated financial statements are presented in accordance with the accrual basis of accounting, whereby revenue is recognized when earned and expenses are recognized when incurred.

The preparation of the consolidated financial statements in conformity with generally accepted accounting principles (GAAP) requires 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 consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could vary from the estimates in the consolidated financial statements.

Cash and Cash Equivalents

For purposes of the consolidated financial statements, the Society considers all investments with an original maturity of three months or less to be cash equivalents.

Accounts Receivable

Accounts receivable are stated at the amount management expects to collect from outstanding balances. Refer to Note H for additional information on these receivables. If an outstanding balance were deemed to be uncollectible, it would be charged against an allowance account. Based on experience, management believes that the entire amount receivable is fully collectible. Therefore, no allowance for doubtful accounts has been recorded.

Marketable Securities and Fair Value Measurement

Marketable securities include investments in publicly traded equity securities and mutual funds and are recorded at fair value. Realized and unrealized gains and losses during the year are recognized in the consolidated statement of activities and are included as a component of investment income. Realized gains and losses are determined on the specific identification method.

North Carolina Medical Society

Notes to Consolidated Financial Statements (Continued)

Note A - Organization and Summary of Significant Accounting Policies (continued)

Marketable Securities and Fair Value Measurement (continued)

Fair value classifications for marketable securities are based on a framework established in the fair value measurement and disclosure accounting guidance. The framework is based on inputs used in the valuation and requires that observable inputs be used in the valuations when available. The levels of the hierarchy are as follows:

Level 1 - Observable inputs that reflect quoted prices for identical securities, traded in active markets that the Society has the ability to access.

Level 2 - Directly or indirectly observable inputs, that are observable for substantially the entire period, other than those included in Level 1 such as quoted market prices for similar securities in active markets, quoted market prices for identical securities in inactive markets, and yield curves.

Level 3 - Management's own assumptions about inputs used in pricing the security.

Property and Equipment

Property and equipment are stated at cost if purchased, or at estimated fair value at the date of the gift, if donated, less accumulated depreciation. Assets are depreciated using the straight-line method over the following estimated useful lives:

<u>Classification</u>	<u>Estimated Useful Life</u>
Building and improvements	10-50 years
Vehicles	5 years
Furniture, fixtures and equipment	3-10 years

Gains or losses on dispositions are included in the consolidated statements of activities. It is the Society's policy to capitalize property and equipment with an original cost of \$500 or more and an estimated useful life of more than one year. Expenditures for repairs and maintenance are charged to expense as incurred. The cost of major renewals and betterments are capitalized and depreciated over their estimated useful lives.

Construction in process is stated at cost, which includes the cost of construction and other direct costs attributable to the construction. No provision for depreciation is made on construction in process until such time as the relevant assets are completed and placed in service.

Agency Obligations

The Society collects membership dues from its members on behalf of certain county medical societies. The Society also collects contributions for the Foundation and other related organizations. These funds are then remitted to the appropriate organization.

North Carolina Medical Society

Notes to Consolidated Financial Statements (Continued)

Note A - Organization and Summary of Significant Accounting Policies (continued)

Net Assets

For financial reporting purposes the consolidated statements of financial position classify net assets into one of three categories: unrestricted, temporarily restricted, or permanently restricted.

Unrestricted - Assets that are not classified as either permanently or temporarily restricted. A portion of the unrestricted net assets have been designated by the Board of Directors for certain purposes.

Temporarily restricted - Assets subject to donor-imposed restrictions which either expire upon the passage of time or once specific actions have occurred. These assets are then released and reclassified to unrestricted support. Restricted contributions received and met in the same year are recorded as unrestricted. The contributions and investment income received by the NCMS PAC are classified as temporarily restricted until disbursed.

Permanently restricted - Assets are subject to donor-imposed restrictions which stipulate the principal be invested in perpetuity. The Society does not maintain any such net assets as of December 31, 2016 or 2015.

Revenue Recognition

Revenues are recognized in the year for which the revenues are earned. Membership dues received prior to year-end for the upcoming dues year are reported as deferred membership dues.

Advertising Costs

The Society charges the costs of advertising to expense as incurred.

Expense Allocation

The costs of providing program services and other activities are reflected on the consolidated statements of activities. Accordingly, certain costs have been allocated among program services and management and general.

Income Taxes

NCMS, the NCMS PAC and CHNC are exempt from income taxes under Section 501(c)(6) of the Internal Revenue Code. Management has concluded that these entities have properly maintained their exempt status. NCMS pays U.S. Federal and North Carolina unrelated business income taxes on income derived from publications, manuals, photocopies, labels, and collection service commissions.

CCHN is a taxable entity and follows the asset and liability method of accounting for income taxes. This method requires recognition of deferred tax assets and liabilities for the future tax consequences of temporary differences between the carrying amount and the tax basis of assets and liabilities. If it is more likely than not that some portion of a deferred tax asset will not be realized, a valuation allowance is recorded.

The Society considers uncertain tax positions and management does not believe there are any significant income tax uncertainties.

North Carolina Medical Society

Notes to Consolidated Financial Statements (Continued)

Note A - Organization and Summary of Significant Accounting Policies (continued)

Reclassifications

Certain reclassifications have been made to the prior year consolidated financial statement presentation to conform with the current year's presentation. Net assets and changes in net assets are unchanged due to these reclassifications.

Subsequent Events

The Society evaluated subsequent events for disclosure and recognition through August 22, 2017, the date on which these consolidated financial statements were available to be issued, and considered any relevant matters in the preparation of the consolidated financial statements and note disclosures.

Note B - Financial Risk

The Society maintains its cash and cash equivalents in various bank deposit accounts which, at times, may exceed federally insured limits. The Society has not experienced any losses in such accounts.

The Society invests in equity securities and mutual funds; such securities are exposed to various risks, such as market and credit risk. Due to the level of risk associated with such securities and the level of uncertainty related to changes in the value of such securities, it is at least reasonably possible that changes in risk in the near term could materially affect security balances and the amounts reported in the consolidated financial statements.

The Society received 16% and 19% of its revenue pursuant to a service agreement with the North Carolina Medical Society Employee Benefit Trust for the years ended December 31, 2016 and 2015, respectively. Accounts receivable related to this agreement represented 45% and 46% of accounts receivable at December 31, 2016 and 2015, respectively (see Note H).

Note C - Marketable Securities and Fair Value Measurement

Investments in marketable securities at December 31, 2016 and 2015 consist of Level 1 securities. The Society did not hold any Level 2 or 3 investments.

Investments, at fair value, are summarized as follows at December 31:

	<u>2016</u>	<u>2015</u>
U.S. common stocks	\$ -	\$ 719,382
Mutual funds:		
U.S. equity securities	2,481,887	2,796,698
U.S. equity securities - ETF	2,882,055	2,157,273
Foreign equity securities	773,015	771,105
Fixed income securities	<u>2,194,063</u>	<u>2,435,117</u>
Total mutual funds	<u>8,331,020</u>	<u>8,160,193</u>
Total investments	<u>\$ 8,331,020</u>	<u>\$ 8,879,575</u>

North Carolina Medical Society

Notes to Consolidated Financial Statements (Continued)

Note C - Marketable Securities and Fair Value Measurements (continued)

The fair value of common stocks and mutual funds is based on identical assets in actively traded markets. Investment fees were \$19,689 and \$23,620, respectively, for the years ended December 31, 2016 and 2015.

Note D - Loans Payable

In February of 2013, the Society borrowed \$2,000,000 under a line of credit from Wells Fargo Bank bearing interest at a rate of 2.5% annually, with a maturity date of March 15, 2019. During 2014, the line of credit was converted to an installment loan, which bears interest at a rate of 2.5% annually. Under the terms of the loan, the Society must make monthly payments of principal and interest. The loan is secured by a security interest and lien upon all monies, securities, securities accounts, brokerage accounts, deposit accounts and other property of the Society now or hereafter in the possession of Wells Fargo Bank or affiliates. During the year ended December 31, 2016, the Society made principal payments on the loan totaling \$465,846.

The following is a schedule of future principal payments under the terms of the Society's loan agreement:

Year ending December 31,	
2017	\$ 416,187
2018	<u>161,091</u>
Total	<u>\$ 577,278</u>

On May 20, 2016, CCHN entered into a Loan and Security Agreement (the loan) with Centene. Centene agreed to provide a multiple term loan of up to \$2,500,000, provided however, that upon the achievement of milestones, the amount of such loan may be increased to an amount up to \$4,000,000. The aggregate unpaid principal amount of all advances outstanding from time to time under the loan bears interest at 6.75% per annum. The loan is secured by all of the CCHN's now owned or hereafter acquired receivables and equity of the joint venture companies. At December 31, 2016, the principal balance outstanding on the loan was \$171,632. Accrued interest at December 31, 2016 was \$2,814 and interest expense from inception through December 31, 2016 was \$2,814. The Society is not a guarantor of the loan.

On January 10, 2017, the parties to the loan agreed to an Amended and Restated Loan and Security Agreement (the amended loan). The amended loan provided for certain amendments and modifications to the loan in order to provide for an additional multiple advance term loan in the amount of \$3 million provided, however, that upon satisfaction of certain conditions in the sole discretion of Centene Corporation, the amount may be increased to \$4 million.

North Carolina Medical Society

Notes to Consolidated Financial Statements (Continued)

Note E - Retirement Savings Plan

The Society has a qualified defined contribution retirement savings plan. Under the terms of the plan, all employees who have more than 90 days of service are eligible to participate. Employee contributions to the plan are made through voluntary contributions by eligible participants. Total employee and employer contributions are not to exceed maximums set by the Internal Revenue Code. For 2016 and 2015, the Society elected to make discretionary contributions of 4% of eligible employee salary plus individualized supplemental contributions for certain long term service employees who were covered under a former defined benefit plan. Total employer contributions for 2016 and 2015 were \$140,732 and \$129,941, respectively.

Note F - Designated Unrestricted Net Assets

The Board of Directors has designated portions of the unrestricted net asset balance for future needs. Marketable securities of \$1,000,000 are designated for the operating reserve for the years ending December 31, 2016 and 2015. Specific assets are not designated for property and equipment replacements, or physician and patient advocacy and protection reserve.

Note G - Commitments and Contingencies

The Society is party to various legal proceedings incidental to its members. Certain claims, suits, and complaints arising in the ordinary course of business have been filed or are pending against the Society. In the opinion of management, these actions will likely be successfully defended or resolved without material adverse effect on the financial position of the Society.

During 2011, the Society made a \$500,000, five-year contingent pledge to the Foundation for the establishment of the Kanof endowment. During 2016 and 2015, pledge payments of \$0 were made. At December 31, 2016 and 2015, \$200,000 remained contingent on the availability of funds. Due to the contingent nature of this pledge, no liability has been recorded as of December 31, 2016 and 2015.

Note H - Related Party Transactions

The Society is related to the Foundation by reason of common management, however, the elements of control necessary for consolidation are not present. The Society receives donations on behalf of the Foundation and distributes these funds to the Foundation. These donations are treated as agency obligations, and are therefore not reflected in the consolidated statements of activities. The accounting records of the Foundation are maintained by Society personnel who also provide legal representation and promotional services to the Foundation. In 2016 and 2015, the Society received \$4,800 and \$12,547, respectively, for these services. The Society also pays certain direct expenses of the Foundation that are reimbursed monthly, these expenses total \$466,140 and \$460,962 in 2016 and 2015, respectively. During 2016 and 2015, the Foundation contributed \$219,778 and \$352,494, respectively, from its NCMS Center for Leadership Capital Campaign for the building renovations, which is included in other revenue in the consolidated statements of activities. Accounts receivable as of December 31, 2016 and 2015 includes \$59,817 and \$52,017, respectively, due from the Foundation. Accounts payable at December 31, 2016 and 2015 includes \$0 due to the Foundation.

North Carolina Medical Society

Notes to Consolidated Financial Statements (Continued)

Note H - Related Party Transactions (continued)

The Society made donations to the Foundation for the following purposes:

	<u>2016</u>	<u>2015</u>
In-kind services	\$ 68,615	\$ 196,265
Facilities	<u>34,474</u>	<u>31,405</u>
	<u>\$ 103,089</u>	<u>\$ 227,670</u>

The Society provides services to affiliated specialty societies and a county medical society. In exchange for these services the Society receives management fees. In 2016 and 2015, the Society earned \$373,085 and \$383,523, respectively, for these services. The Society also pays certain direct expenses on behalf of these affiliates that are reimbursed monthly/quarterly; these expenses total \$118,025 and \$90,998 in 2016 and 2015, respectively. At December 31, 2016 and 2015, \$137,741 and \$119,124, respectively, are due from these affiliates. The Society had accounts payable of \$0 and \$32,825 due to these affiliates at December 31, 2016 and 2015, respectively.

NCMS provides certain accounting and management services to CCHN, and also pays certain expenses on behalf of CCHN. NCMS's receivable balances of \$29,929 of funding advances, expenses of \$303,106 for services, \$144,627 for legal expense, and \$17,594 of consulting expense incurred during 2016 have been eliminated as part of the consolidation process. These receivable balances will be settled no earlier than the closing of the joint venture. Before consolidation eliminations, CCHN expenses for the period ending December 31, 2016 totaled \$767,581.

The Society has an unfunded non-qualified deferred compensation plan for certain officers and directors. As of December 31, 2016 and 2015, the total liability of this plan was \$131,428 and \$144,643, respectively. The total expenses for this plan were \$44,286 and \$49,286 for the years ended December 31, 2016 and 2015, respectively.

The Society sponsors the North Carolina Medical Society Employee Benefit Trust, which is a North Carolina domiciled multiple employer welfare arrangement (MEWA). The Society provides services in the form of communications, marketing, and customer services pursuant to a service agreement. The Society receives a service fee based on the number of enrolled employees per month. For the years ended December 31, 2016 and 2015 the service fee totaled \$901,873 and \$888,105, respectively. As of December 31, 2016 and 2015, the Society had accounts receivable due from the MEWA of \$217,089 and \$219,399 respectively.

Note I - CCHN Income Taxes

CCHN recognizes deferred taxes for temporary differences between the basis of assets and liabilities for financial statement and income tax purposes. The differences relate primarily to the treatment of organizational costs, start-up costs, and accrued expenses. The deferred tax asset as of December 31, 2016 was \$224,138, composed of \$223,181 in organizational and start up costs and \$957 of accrued expenses.

North Carolina Medical Society

Notes to Consolidated Financial Statements (Continued)

Note I - CCHN Income Taxes (continued)

CCHN recognizes deferred tax assets to the extent that it believes that these assets are more likely than not to be realized. In making such determination, CCHN considers all available positive and negative evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax-planning strategies, and results of recent operations. CCHN assessed the need for a valuation allowance against its net deferred tax assets and determined a full valuation allowance is required for the year ended December 31, 2016 due to uncertainty regarding future revenue generating activities. Therefore a full valuation allowance of \$224,138 was recorded for the year ended December 31, 2016.

CCHN's ability to utilize net operating loss carryforwards will depend on its ability to generate future taxable income. CCHN's ability to utilize its tax attributes may be limited in the event that a change in ownership, as defined in Section 382 of the Internal Revenue Code of 1986, as amended, occurs in the future.

CCHN's effective federal tax rate for the year ended December 31, 2016 differs from the statutory rate of 34% as follows:

Expected tax	\$	(260,978)
Permanent differences		36,840
Change in valuation allowance		<u>224,138</u>
Total expense incurred	\$	<u><u>-</u></u>

North Carolina Medical Society

Schedule of Changes in Unrestricted Net Assets

For the years ended December 31, 2016

	Operating Reserve	Property and Equipment Replacements *	Physician and Patient Advocacy and Protection Reserve	Undesignated	Total Unrestricted Net Assets
Balance, beginning of year	\$ 1,000,000	\$ 3,397,509	\$ 791,372	\$ 7,958,095	\$ 13,146,976
Change in unrestricted net assets	-	-	-	(110,022)	(110,022)
Balance, end of year	\$ 1,000,000	\$ 3,397,509	\$ 791,372	\$ 7,848,073	\$ 13,036,954

North Carolina Medical Society

Schedule of Other Revenue

For the years ended December 31, 2016 and 2015

	2016 Budget (Unaudited)	2016 Actual	Over (Under) Budget	2015 Actual
Unrestricted				
Annual meeting revenue	\$ 175,000	\$ 152,337	\$ (22,663)	\$ 50,650
Accreditation of CME fees	50,000	59,000	9,000	45,500
Foundation - services	4,800	4,800	-	12,547
Photocopy and label income	12,000	24,824	12,824	23,434
Toward Accountable Care	-	6,500	6,500	-
Other	-	57,663	57,663	39,395
	-	57,663	57,663	39,395
Total unrestricted	\$ 241,800	\$ 305,124	\$ 63,324	\$ 171,526

North Carolina Medical Society

Schedule of Department Expenses

For the year ended December 31, 2016

	Specialty and Meetings Services	Operations, Member Services, and Executive	Government Affairs	Headquarters Facility	Healthcare Delivery	Communication and Marketing	Member Development	Other Programs	CCH Network	NCMS PAC	CHNC	Total
Salaries, benefits, and taxes	\$ 427,235	\$ 1,276,677	\$ 820,856	\$ -	\$ 231,784	\$ 317,809	\$ 149,713	\$ -	\$ -	\$ -	\$ -	\$ 3,224,074
Travel	5,989	30,696	28,735	-	15,489	3,778	11,058	-	-	-	-	95,745
Dues and subscriptions	1,660	22,194	9,669	-	1,188	1,313	-	-	-	-	-	36,024
Employee development	(316)	12,703	325	-	-	9,110	-	-	-	-	-	21,822
Bank fees	-	48,127	-	-	-	-	-	-	-	-	-	48,127
Computer supplies and upgrades	-	39,065	-	-	-	-	-	-	-	-	-	39,065
Professional fees, special projects, and consulting	-	26,550	43,485	4,067	-	-	-	-	150,542	-	-	224,644
Postage, phone, and office supplies	-	74,020	10,249	-	584	-	-	-	-	-	-	84,853
Business insurance	-	41,314	-	-	-	-	-	-	-	-	-	41,314
Maintenance	-	64,323	-	78,901	-	-	-	-	-	-	-	143,224
Taxes	-	60	-	-	-	-	-	-	-	-	-	60
Interest expense	-	21,820	-	-	-	-	-	-	2,814	-	-	24,634

Continued

North Carolina Medical Society

Schedule of Department Expenses (continued)

For the year ended December 31, 2016

	Specialty and Meetings Services	Operations, Member Services, and Executive	Government Affairs	Headquarters Facility	Healthcare Delivery	Communication and Marketing	Member Development	Other Programs	CCH Network	NCMS PAC	CHNC	Total
AMA delegation Presidents, Board, and committees	-	-	-	-	-	-	-	55,755	-	-	-	55,755
Annual meeting	-	-	-	-	-	-	-	92,391	-	-	-	92,391
Legislative relations	-	-	233,946	-	-	-	-	20,463	-	-	-	254,409
Legal Meetings	-	7,164	184,114	-	-	-	-	-	148,898	-	-	340,176
Building services	-	4,400	9,264	-	-	-	-	-	-	-	-	13,664
Depreciation	-	-	-	97,076	-	-	-	-	-	-	-	97,076
Program grants	-	-	-	413,216	-	-	-	-	-	-	-	413,216
Medical education and accreditation	-	5,461	-	-	-	-	-	30,000	-	-	-	35,461
Towards Accountable Care	-	-	-	-	-	-	-	9,500	-	-	-	9,500
Marketing, recruitment, and member activities	-	-	-	-	600	-	-	-	-	-	-	600
Communication expense	-	-	-	-	-	65,131	154,417	-	-	-	-	219,548
Candidate support	-	-	-	-	-	8,032	-	-	-	-	14,925	22,957
Other expense	11	-	-	-	-	-	-	-	-	157,001	-	157,001
Total	<u>\$ 434,579</u>	<u>\$ 1,674,574</u>	<u>\$ 1,340,643</u>	<u>\$ 593,260</u>	<u>\$ 249,645</u>	<u>\$ 405,173</u>	<u>\$ 315,188</u>	<u>\$ 376,063</u>	<u>\$ 302,254</u>	<u>\$ 157,001</u>	<u>\$ 14,925</u>	<u>\$ 5,863,305</u>

North Carolina Medical Society

Schedule of Department Expenses

For the year ended December 31, 2015

	Specialty and Meetings Services	Operations, Member Services, and Executive	Government Affairs	Headquarters Facility	Healthcare Delivery	Communication and Marketing	Member Development	Other Programs	NCMS PAC	Total
Salaries, benefits, and taxes	\$ 420,137	\$ 1,380,475	\$ 769,181	\$ -	\$ 208,441	\$ 309,588	\$ 75,884	\$ -	\$ -	\$ 3,163,706
Travel	2,949	40,696	22,861	-	2,686	3,828	5,574	-	-	78,594
Dues and subscriptions	3,054	9,074	16,001	-	871	1,242	61	-	-	30,303
Employee development	530	31,916	650	-	325	-	-	-	-	33,421
Bank fees	-	40,960	-	-	-	-	-	-	-	40,960
Computer supplies and upgrades	-	44,228	-	-	-	-	-	-	-	44,228
Professional fees, special projects, and consulting	-	20,610	-	-	-	-	-	-	-	20,610
Postage, phone, and office supplies	-	83,518	10,104	-	478	-	-	-	-	94,100
Business insurance	-	23,840	-	-	-	-	-	-	-	23,840
Maintenance	-	46,682	-	78,345	-	-	-	-	-	125,027
Taxes	-	158	-	-	-	-	-	-	-	158
Bad debt	-	28,445	-	-	-	-	-	-	-	28,445
Interest expense	-	36,231	-	-	-	-	-	-	-	36,231
Asset disposal	-	-	-	3,104	-	-	-	-	-	3,104

Continued

North Carolina Medical Society

Schedule of Department Expenses (continued)

For the year ended December 31, 2015

	Specialty and Meetings Services	Operations, Member Services, and Executive	Government Affairs	Headquarters Facility	Healthcare Delivery	Communication and Marketing	Member Development	Other Programs	NCMS PAC	Total
AMA delegation	-	-	-	-	-	-	-	44,132	-	44,132
Presidents, Board, and committees	-	-	-	-	-	-	-	105,951	-	105,951
Annual meeting	-	-	-	-	-	-	-	99,357	-	99,357
Legislative relations	-	-	245,426	-	-	-	-	24,642	-	270,068
Legal	-	-	1,415	-	-	-	-	-	-	1,415
Building services	-	-	-	95,405	-	-	-	-	-	95,405
Depreciation	-	-	-	439,926	-	-	-	-	-	439,926
Program grants	-	-	-	-	-	-	-	30,000	-	30,000
Medical education and accreditation	-	-	-	-	-	-	-	8,695	-	8,695
Towards Accountable Care	-	-	-	-	644	-	-	-	-	644
Marketing, recruitment, and member activities	-	-	-	-	-	34,296	127,585	-	-	161,881
Communication expense	-	-	-	-	-	14,804	-	-	-	14,804
Candidate support	-	-	-	-	-	-	-	-	30,000	30,000
Other expense	958	-	-	-	-	-	-	644	-	1,602
Total	\$ 427,628	\$ 1,786,833	\$ 1,065,638	\$ 616,780	\$ 213,445	\$ 363,758	\$ 209,104	\$ 313,421	\$ 30,000	\$ 5,026,607

North Carolina Medical Society

Schedule of Assets and Net Assets of NCMS PAC

For the years ended December 31, 2016 and 2015

Assets	<u>2016</u>	<u>2015</u>
Cash and cash equivalents	\$ 14,838	\$ 108,610
Investments	<u>1,606</u>	<u>3,541</u>
Total assets	<u>\$ 16,444</u>	<u>\$ 112,151</u>
Net Assets		
Temporarily restricted	<u>\$ 16,444</u>	<u>\$ 112,151</u>

North Carolina Medical Society

Schedule of Assets and Net Assets of CHNC

For the year ended December 31, 2016

	<u>2016</u>
Assets	
Cash and cash equivalents	<u>\$ 5,075</u>
 Total assets	 <u><u>\$ 5,075</u></u>
 Net Assets	
Temporarily restricted	<u><u>\$ 5,075</u></u>