AMERICAN ACADEMY OF FAMILY PHYSICIANS FOUNDATION AND SUBSIDIARY

YEARS ENDED DECEMBER 31, 2011 AND 2010

HOUSE PARK & DOBRATZ, P.C.
CERTIFIED PUBLIC ACCOUNTANTS

AMERICAN ACADEMY OF FAMILY PHYSICIANS FOUNDATION AND SUBSIDIARY

YEARS ENDED DECEMBER 31, 2011 AND 2010

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Independent Auditors' Report

Board of Trustees
American Academy of Family Physicians Foundation
Leawood, Kansas

We have audited the accompanying consolidated statements of financial position of American Academy of Family Physicians Foundation and Subsidiary (the Organization) as of December 31, 2011 and 2010, and the related consolidated statements of activities and changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. The prior year summarized comparative information in the consolidated statement of activities has been derived from the Organization's 2010 financial statements. We did not audit the financial statements of AAFP Insurance Services, Inc., a wholly-owned subsidiary, which statements reflect total assets of $4,830,986 and $4,650,565 as of December 31, 2011 and 2010, respectively, and total revenues of $3,514,842 and $3,462,722, respectively, for the years then ended. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for AAFP Insurance Services, Inc., is based solely on the report of the other auditors.

We conducted our audits in accordance with U.S. generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated 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 and the report of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of American Academy of Family Physicians Foundation and Subsidiary as of December 31, 2011 and 2010, and the changes in their consolidated net assets and their consolidated cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

House Park & Dobratz, P.C.

May 19, 2012

AMERICAN ACADEMY OF FAMILY PHYSICIANS FOUNDATION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

DECEMBER 31, 2011 AND 2010

ASSETS

	2011	2010
Cash and cash equivalents (Note 4)	$ 12,909,997	$ 9,938,988
Accounts receivable (Note 10)	850,601	928,593
Beneficial interest in trust assets (Note 3)	34,377	35,896
Prepaid expenses	162,772	70,447
Investments at fair value (Notes 2, 3 and 4)	10,754,996	10,708,425
Office equipment, furniture and fixtures, net of accumulated depreciation of $672,867 and $637,356 as of December 31, 2011 and 2010, respectively	132,133	144,236
	$ 24,844,876	$ 21,826,585

LIABILITIES AND NET ASSETS

	2011	2010
Liabilities:		
Accounts payable (Note 10)	$ 4,549,233	$ 5,593,209
Deferred revenue and advances (Note 11)	5,915,705	2,199,914
Deferred income taxes (Note 7)	5,564	6,892
Liabilities under split-interest agreements (Note 3)	57,642	64,715
Federal and state income taxes payable (receivable) (Note 7)	25,331	(4,226)
Grant awards payable	321,927	366,942
Total liabilities	10,875,402	8,227,446
Commitments (Notes 8 and 12)		
Net assets:		
Unrestricted:		
Undesignated	3,097,154	2,525,366
Equity in office equipment, furniture and fixtures	39,843	53,121
Board-designated (Note 4)	8,402,801	8,522,463
Total unrestricted	11,539,798	11,100,950
Temporarily restricted (Note 4)	1,028,631	1,157,330
Permanently restricted (Note 4)	1,401,045	1,340,859
Total net assets	13,969,474	13,599,139
	$ 24,844,876	$ 21,826,585

See notes to consolidated financial statements.

AMERICAN ACADEMY OF FAMILY PHYSICIANS FOUNDATION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS

YEAR ENDED DECEMBER 31, 2011
(With comparative totals for the year ended December 31, 2010)

	2011		
	American Academy of Family Physicians Foundation		
	Unrestricted	Temporarily restricted	Permanently restricted
Revenues and support:			
Insurance revenues	$ --	$ --	$ --
Individual donations (Note 10)	480,213	121,318	25,186
Corporate and chapter support	1,253,740	40,100	35,000
Grants	22,889	3,397,390	--
Special events, net of direct expenses of $23,622 and $31,488 in 2011 and 2010, respectively	23,801	2,032	--
Investment income (loss) (Notes 2 and 3)	(140,311)	(8,274)	--
Other	--	--	--
Net assets released from restrictions, satisfaction of donor stipulations (Note 4)	3,675,818	(3,675,818)	--
Total revenues and support	5,316,150	(123,252)	60,186
Expenses:			
Board, general staff and administration	436,876	--	--
Family Medicine Philanthropic Consortium	107,368	--	--
Center for the History of Family Medicine	179,889	--	--
Grant awards and administration	1,278,640	--	--
Teacher Development Awards program	62,595	--	--
Individual development	681,033	--	--
Professional and corporate affairs	181,906	--	--
Communications and public relations	--	--	--
Programs, other	848,482	--	--
Peers for Progress (Note 11)	2,049,597	--	--
Income taxes (Note 7)	--	--	--
Total expenses (Note 6)	5,826,386	--	--
Change in net assets	(510,236)	(123,252)	60,186
Equity in income of subsidiary	943,637	--	--
Transfers	5,447	(5,447)	--
Net assets, beginning of year	11,100,950	1,157,330	1,340,859
Net assets, end of year	$ 11,539,798	$ 1,028,631	$ 1,401,045

2011 AAFP Foundation total	2011 AAFP Insurance Services, Inc.	2011 Consolidated totals	2010 Consolidated totals
$ --	$ 3,494,191	$ 3,494,191	$ 3,462,685
626,717	--	626,717	675,044
1,328,840	--	1,328,840	1,182,150
3,420,279	--	3,420,279	6,093,920
25,833	--	25,833	44,138
(148,585)	--	(148,585)	1,063,541
--	20,651	20,651	51
--	--	--	--
5,253,084	3,514,842	8,767,926	12,521,529
436,876	1,702,572	2,139,448	2,254,249
107,368	--	107,368	129,411
179,889	--	179,889	150,348
1,278,640	--	1,278,640	2,217,939
62,595	--	62,595	51,599
681,033	199,442	880,475	857,301
181,906	8,437	190,343	165,006
--	38,682	38,682	39,309
848,482	--	848,482	776,831
2,049,597	--	2,049,597	3,855,513
--	622,072	622,072	596,296
5,826,386	2,571,205	8,397,591	11,093,802
(573,302)	943,637	370,335	1,427,727
943,637	(943,637)	--	--
--	--	--	--
13,599,139	--	13,599,139	12,171,412
$ 13,969,474	$ --	$ 13,969,474	$ 13,599,139

See notes to consolidated financial statements.

AMERICAN ACADEMY OF FAMILY PHYSICIANS FOUNDATION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2011 AND 2010

	2011	2010
Reconciliation of change in net assets to net cash provided by operating activities:		
Cash flows from operating activities:		
Change in net assets/net income	$ 370,335	$ 1,427,727
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	56,186	44,571
Realized (gains) losses	(82,300)	257,766
Unrealized (gains) losses	396,863	(1,177,440)
Change in value of split-interest agreements	4,001	(11,647)
Change in operating assets and liabilities:		
Accounts receivable	77,992	(208,145)
Prepaid expenses	(92,325)	1,850
Accounts payable	(1,043,976)	911,491
Deferred revenue and advances	3,715,791	1,844,668
Deferred income taxes	(1,328)	2,728
Federal and state income taxes payable	29,557	(106,274)
Grant awards payable	(45,015)	67,826
Net cash provided by operating activities	3,385,781	3,055,121
Cash flows from investing activities:		
Purchase of office equipment, furniture and fixtures	(44,083)	(48,564)
Purchase of investments	(370,689)	(432,616)
Net cash used by investing activities	(414,772)	(481,180)
Increase in cash and cash equivalents	2,971,009	2,573,941
Cash and cash equivalents, beginning of year	9,938,988	7,365,047
Cash and cash equivalents, end of year	$ 12,909,997	$ 9,938,988
Supplemental disclosures of cash flow information:		
Amounts paid for federal and state income taxes (Note 7)	$ 595,831	$ 699,842

See notes to consolidated financial statements.

1. Organization and summary of significant accounting policies:

Organization and principles of consolidation:

The American Academy of Family Physicians Foundation (the Foundation) is a not-for-profit organization whose primary activity is serving as a fiscal intermediary for programs that serve to promote and benefit family medicine throughout the United States. The Foundation encourages philanthropy, awards research grants, offers education programs and maintains a center for the history of family medicine. The Foundation's donors and members are located primarily throughout the Unites States of America.

AAFP Insurance Services, Inc. (Insurance Services) is a wholly-owned, for-profit subsidiary of the American Academy of Family Physicians Foundation. Insurance Services administers and sells various types of insurance plans (life, medical, disability, accidental death, etc.) to members of the American Academy of Family Physicians (the Academy), the sole contract holder of such plans. Insurance Services maintains a relationship with one insurance company that services a majority of these plans and is the source for a significant portion of revenues from insurance plans. Insurance Services' insured are located primarily throughout the United States of America.

The consolidated financial statements include the financial position, operations, cash flows and changes in net assets of the Foundation and Insurance Services (collectively referred to as the Organization). Inter-entity transactions and balances have been eliminated for financial statement purposes.

The consolidated statement of activities includes certain prior year summarized comparative information in total, but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with U.S. generally accepted accounting principles (GAAP). Accordingly, such information should be read in conjunction with the Organization's financial statements for the year ended December 31, 2010, from which the summarized information is derived.

Accounts receivable:

Accounts receivable consists primarily of Foundation donations collected by the Academy and commissions due from an insurance carrier. Neither the Foundation nor Insurance Services requires collateral for the accounts. Balances become past due according to the terms of various agreements with the chapters, organizations who handle the initial processing and insurance carriers. Balances that are still outstanding after management has used reasonable collection efforts are charged to expense when that determination is made. Management believes that all accounts receivable are collectible; therefore, no allowance for uncollectible accounts has been established.

Advertising:

Insurance Services expenses advertising and other promotional costs as they are incurred. These types of expenses for mailing campaigns, newsletters and similar activities totaled $223,093 for 2011 and $314,000 for 2010.

1. Organization and summary of significant accounting policies (continued):

Basis of presentation:

The accompanying financial statements have been prepared on the accrual basis of accounting. All financial transactions have been recorded in and reported by the following net asset groups:

Unrestricted net assets consist of funds free of any donor-imposed restrictions and are classified into undesignated funds and Board-designated funds. The Board-designated funds represent a portion of unrestricted donations received, which are set aside by the Board for the future general operation and administration of the Foundation.

Temporarily restricted net assets are those whose use by the Foundation has been limited by donors to a specific time period or purpose.

Permanently restricted net assets are those contributions whose use by the Foundation is limited by donor-imposed stipulations that the corpus be held in perpetuity. The earnings from these net assets are available for use for temporarily restricted purposes or are added to the corpus as specified by the donor.

Cash equivalents:

For purposes of the consolidated statements of cash flows, cash equivalents consist primarily of money market accounts and are carried at cost which approximates fair value.

Contributions:

Contributions received by the Foundation are recorded as unrestricted, temporarily restricted, or permanently restricted support depending on the existence and/or nature of any donor restrictions. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets. Contributions to certain programs are considered unrestricted support when the restrictions are met in the same reporting year.

Fair value of financial instruments:

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The framework for measuring fair value provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

1. Organization and summary of significant accounting policies (continued):

Fair value of financial instruments (continued):

Level 1 – Quoted prices for identical instruments in active markets.

Level 2 – Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in inactive markets; or derived from inputs that are observable. Also included in Level 2 are investments measured using net asset value (NAV) per share, or its equivalent, that may be redeemed at that NAV at or near the reporting date.

Level 3 – Significant unobservable inputs that are significant to the fair value of the assets or liabilities

The carrying amount of financial instruments including cash and cash equivalents, accounts receivable, prepaid expenses, accounts payable, deferred revenue, income taxes payable and grants payable approximated fair values as of December 31, 2011 and 2010 due to their short-term nature. The fair value of investments is disclosed in Note 2.

Investments are presented at fair value as determined by methodologies relevant to each asset class with any related gain or loss reported in the statement of activities. Marketable securities are held by a custodian and are stated at fair value based on quoted market prices. Alternative investments, including hedge funds and commodity funds, are valued using net asset values provided by external investment managers as a practical expedient in determining fair value. Because such investments are not readily marketable, the estimated value is subject to uncertainty and therefore may differ materially from the value that would have been used had a ready market for such investments existed.

The Foundation holds units in a pooled investment fund administered by the Academy. The pooled investment fund investments include money market funds and equity and fixed income funds. The Foundation reflects the investments in the pooled investment funds at the Academy at NAV (Level 2) as a practical expedient to fair value, because these investments have a readily determined value and transact frequently. The underlying holdings in these funds are valued by the respective managers or custodians using quoted market prices for publicly traded securities and fair value for other investments, using methodologies relevant to each asset class. The valuations are routinely evaluated by management, and management believes such values are reasonable.

1. Organization and summary of significant accounting policies (continued):

Investments and concentrations of credit risk:

Financial instruments which potentially subject the Organization to significant concentrations of credit risk consist principally of cash, accounts receivable and investments. The Organization maintains its bank accounts at two institutions where accounts are fully insured by the Federal Deposit Insurance Corporation through December 31, 2012. As of December 31, 2011, cash and cash equivalents includes $8,515,073 invested by the Foundation in a mutual fund which holds certificates of deposit and fixed income securities. These funds are not covered by FDIC insurance.

Investment securities, in general, are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain 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 amounts reported as net assets in the consolidated statements of financial position.

Certain assets are pooled for investment purposes. Related investment income, net of investment expenses, and net realized and unrealized gains and losses are allocated to each component fund based on a ratio of the individual weighted average fund balance to total weighted average fund balance.

Income tax status:

The Foundation is an organization as described in Section 501(c)(3) of the Internal Revenue Code (IRC), and has received a determination letter from the Internal Revenue Service (IRS) that it is exempt from federal income tax on its related exempt activities under IRC 501(a). The Foundation's current accounting policy is to provide liabilities for uncertain income tax provisions when a liability is probable and estimable. The Foundation has no uncertain income tax positions for the years ended December 31, 2011 and 2010. The Foundation is no longer subject to audits by the IRS for years prior to 2008. Management is not aware of any violation of its tax status as an organization exempt from income taxes.

Insurance Services is a for-profit entity. Income taxes are provided for the tax effects of Insurance Services transactions reported in the financial statements and consist of taxes currently due plus deferred taxes. Deferred taxes are recognized for differences between the basis of assets or liabilities for financial statement and income tax purposes and are measured using the enacted tax rates and laws anticipated to be in effect when the differences are expected to reverse.

The differences relate to depreciable assets (use of accelerated depreciation methods) and accrued expenses (timing differences on deductibility). The deferred tax assets or liabilities represent the future tax return consequences of those differences, which will either be deductible or taxable when the assets or liabilities are recovered or settled.

1. Organization and summary of significant accounting policies (continued):

Income tax status (continued):

Insurance Services has adopted the provisions of ASC 740-10 *Accounting for Uncertain Income Tax Positions* as it might apply to Insurance Services' financial transactions. Insurance Services' policy is to record a liability for any tax position that is beneficial to Insurance Services, including any related interest and penalties, when it is more likely than not the position taken by management with respect to the transaction or class of transactions will be overturned by a taxing authority upon examination. Management believes there are no such positions as of December 31, 2011 and, accordingly, no liability has been accrued. However, Insurance Services' federal income tax returns for 2008, 2009 and 2010 are subject to examination by the IRS, generally for three years after they are filed.

Office equipment, furniture and fixtures:

Office equipment, furniture and fixtures are stated at cost if purchased or at fair value if donated. Depreciation is charged to operations using the straight-line method over the estimated useful lives of the assets (three to ten years).

Revenue recognition:

Insurance Services' revenues are based upon broker and service agreements between Insurance Services and the insurance companies that provide coverage. Commissions and administrative allowances are accrued on premiums collected in the period earned.

Use of estimates:

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported amounts of revenues and expenses. Actual results could differ from those estimates.

Subsequent events:

Subsequent events have been evaluated through May 19, 2012, which is the date the financial statements were available to be issued.

2. Investments:

Investments of the Foundation are reported at fair value and consist of the following:

	2011	2010
Common and preferred stock	$ 5,639,017	$ 4,745,238
Corporate bonds	1,373,115	942,390
Equity funds	698,734	1,528,680
Fixed income funds	36,285	716,737
Gold fund	462,810	416,160
Treasury and federal agency obligations	1,110,481	914,181
Investment in pooled funds at the Academy	798,593	801,024
Hedge funds	85,125	162,149
Certificate of deposit	200,000	200,000
Cash and equivalents	350,836	281,866
	$ 10,754,996	$ 10,708,425

Assets held as investments for planned giving programs totaled $127,941 and $137,495 at December 31, 2011 and 2010, respectively. These amounts are included in investments and consist almost exclusively of equities and fixed income funds.

Investment income (loss) from the Foundation investments is summarized as follows:

	2011	2010
Interest and dividends	$ 238,083	$ 184,964
Investment fees and expenses	(68,104)	(52,744)
Realized gains (losses)	82,300	(257,766)
Unrealized gains (losses)	(396,863)	1,177,440
Change in value of split-interest agreements (Note 3)	(4,001)	11,647
	($ 148,585)	$ 1,063,541

2. Investments (continued):

The following is a summary of the inputs used in valuing the Foundation's investments carried at fair value:

	December 31 2011	Level 1	Level 2	Level 3
Common and preferred stock	$ 5,639,017	$ 5,639,017	--	--
Corporate bonds	1,373,115	--	$ 1,373,115	--
Equity funds	698,734	698,734	--	--
Fixed income funds	36,285	36,285	--	--
Gold fund	462,810	462,810	--	--
Treasury and federal agency obligations	1,110,481	--	1,110,481	--
Investment in pooled funds at the Academy	798,593	--	798,593	--
Hedge funds	85,125	--	--	$ 85,125
Certificate of deposit	200,000	200,000	--	--
Cash and equivalents	350,836	350,836	--	--
	$ 10,754,996	$ 7,387,682	$ 3,282,189	$ 85,125

	December 31 2010	Level 1	Level 2	Level 3
Common and preferred stock	$ 4,745,238	$ 4,745,238	--	--
Corporate bonds	942,390	--	$ 942,390	--
Equity funds	1,528,680	1,528,680		
Fixed income funds	716,737	716,737	--	--
Gold fund	416,160	416,160		
Treasury and federal agency obligations	914,181	--	914,181	--
Investment in pooled funds at the Academy	801,024	--	801,024	--
Hedge funds	162,149	--	--	$ 162,149
Certificate of deposit	200,000	200,000	--	--
Cash and equivalents	281,866	281,866	--	--
	$ 10,708,425	$ 7,888,681	$ 2,657,595	$ 162,149

2. Investments (continued):

Units in pooled investment funds at the Academy are reported at net asset value as a practical expedient to estimate the fair value of the Foundation's interest therein. Classification of these funds as Level 2 is based on the Foundation's ability to redeem its interest at or near the date of the statement of financial position. The hedge fund is in the process of liquidation with expected payouts through 2015.

The classification of investments in the fair value hierarchy is not necessarily an indication of the risks, liquidity, or degree of difficulty in estimating the fair value of each investment's underlying assets and liabilities.

The following is a reconciliation of investments in which significant unobservable inputs (Level 3) were used in determining fair value:

	Hedge fund
December 31, 2009	$ 753,913
Interest income	671
Realized losses	(99,892)
Unrealized gains	102,965
Transfers to Level 1	(595,508)
December 31, 2010	162,149
Interest income	333
Realized losses	(18,602)
Unrealized gains	17,605
Transfers to Level 1	(76,360)
December 31, 2011	$ 85,125

Transfers between levels are recorded at the end of each fiscal year. Transfers from Level 3 to Level 1 in 2011 and 2010 represented a portion of the proceeds from redemption of hedge funds.

3. Split-interest agreements:

Charitable Remainder Trusts:

The Foundation is the named beneficiary of two Charitable Remainder Unitrusts (CRUTs). These split interest agreements provide for a lifetime benefit to be paid to the donor or other designated beneficiary. Upon the death of the beneficiary(ies), the remaining trust assets are distributed to charitable remainder beneficiaries as provided in the trust document. The Foundation is the trustee and sole remainder beneficiary of one of the CRUTs. The assets held in this trust totaled $48,729 as of December 31, 2011 and are included in investments. Based on the value of the assets and the age of the beneficiaries, the Foundation has recorded a liability of $34,357 at December 31, 2011, equal to the present value of the estimated future obligations based on mortality rates derived from ordinary life annuity tables. The decrease in the net value of the CRUT of ($546) is included in "investment return" in the statement of activities for 2011.

The other CRUT names the Foundation as beneficiary of the remainder interest but the Foundation is not the trustee. Therefore, the present value of the estimated remainder interest attributable to the Foundation of $34,377 is recorded as "beneficial interest in trust assets" as of December 31, 2011. The decrease in this receivable of ($1,519) is included in "investment return" in the statement of activities for 2011.

Pooled income fund:

Donors contribute assets to an investment pool and are assigned a specific number of units based on the proportion of the fair value of their contribution to the total fair value of the pooled income fund on the date of the donor's entry to the pooled fund. The contributed assets are recorded at fair value. A contribution is recorded at the fair value of the assets discounted for the estimated time period until the donor's death. The difference between the fair value of the assets received and the revenue recognized is recorded as deferred revenue, representing the amount of the discount for future interest. Until a donor's death, the donor or donor's designated beneficiary is paid the actual ordinary income earned on the donor's units. Upon the donor's death, the fair value of the units is released to the Foundation or other designated charitable beneficiary for unrestricted use. No additional pooled income fund contributions were received in 2011 or 2010.

The fair value of the pooled income fund assets of $79,211 is included in investments in the accompanying consolidated statements of financial position as of December 31, 2011. Periodic income on the pooled income fund and payments to the donors are reflected as increases and decreases in the liability to the donors, $571 as of December 31, 2011, which is included in "liabilities under split-interest agreements." The present value of the future interest is calculated using discount rates ranging from 5.75% to 8.75% and applicable life expectancy tables. The estimated future liability of the pooled income fund contributions of $22,714 is recognized as deferred revenue and is included in "liabilities under split-interest agreements". The decrease in the net value of the pooled income fund of ($1,935) is included in "investment return" in the statement of activities for 2011.

4. Net assets:

Certain net assets have been designated or appropriated by the Board as follows:

	2011	2010
General endowment	$ 7,522,609	$ 7,613,652
Archives endowment	730,039	730,933
Family Medicine Philanthropic Consortium	130,215	127,878
Family Medicine Cares	19,938	50,000
Total Board-designated net assets	$ 8,402,801	$ 8,522,463

Temporarily restricted net assets consist of cash and investments and are held for the following purposes at December 31:

	2011	2010
Resident Repayment Program	$ 483,941	$ 483,941
Pass-through grants	92,166	96,539
Stern Lectureship Fund	79,560	81,797
Immunization program	75,655	115,137
Teacher Development Awards	5,808	68,421
Pooled income fund	55,928	57,863
CRT planned gifts	48,747	50,812
Visiting Professorship Program	13,026	46,016
International fund	51,275	53,670
Nutrition Grant	36,237	42,051
Health Literacy fund	3,469	3,108
Disaster relief fund	25,819	28,857
Family Medicine Cares	35,501	
Research Skills Seminar	6,342	6,715
Sundry	15,157	22,403
	$ 1,028,631	$ 1,157,330

4. Net assets (continued):

Net assets released from temporary restrictions due to satisfaction of donor restrictions are as follows:

	2011	2010
Peers for Progress	$ 2,125,686	$ 4,058,435
Highlight on Diabetes	143,023	
Pass-through grants	636,431	1,435,536
Time to Talk Cardio	125,000	378,215
Immunization program	289,483	217,479
Visiting Professorship Program	95,990	63,368
Teacher Development Awards	63,615	54,251
Research Skills Seminar	1,261	26,126
International fund	64,564	72,159
Nutrition Grant	5,814	
Cities for Life	16,397	
Behavior Economics Roundtable	48,000	
Bulletin		20,000
Fellowship awards	1,000	9,000
Health Literacy fund	500	24,500
Disaster relief	50,550	72,708
Sundry	8,504	19,402
	$ 3,675,818	$ 6,451,179

The Foundation's permanently restricted net assets consist of six individual funds established for a variety of purposes and include both donor-restricted endowment funds and funds designated by the Board of Trustees. The Foundation's policy requires the preservation of the fair value as of the gift date of donor-restricted endowment funds absent explicit donor stipulations to the contrary. Based on its interpretation of state law regarding management of endowment funds, the Foundation classifies as permanently restricted net assets the original value of the gifts to the permanent endowment, the fair value of any subsequent gifts to the endowment and any accumulation required to be made by donor stipulation. Amounts in excess of the stated value of permanently restricted funds are classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Foundation.

The Foundation has investment and expenditure policies that consider the purpose of the donor-restricted fund, general economic conditions, and expected investment returns. From time to time, the fair value of net assets associated with individual donor-restricted endowment funds may fall below the level the donor required the Foundation to retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature would be appropriated from unrestricted funds. As of December 31, 2011 and 2010, these deficiencies totaled $56,944 and $44,711, respectively.

4. Net assets (continued):

Endowment net assets composition by type of fund as of December 31, 2011 and 2010 is as follows:

	Unrestricted	Temporarily restricted	Permanently restricted	Total
December 31, 2011:				
Donor-restricted endowment funds	($ 56,944)	$ 1,801	$ 1,401,045	$ 1,345,902
Board-designated endowment funds	8,252,648	--	--	8,252,648
	$ 8,195,704	$ 1,801	$ 1,401,045	$ 9,598,550
December 31, 2010:				
Donor-restricted endowment funds	($ 44,711)	$ 5,550	$ 1,340,859	$ 1,301,698
Board-designated endowment funds	8,344,585	--	--	8,344,585
	$ 8,299,874	$ 5,550	$ 1,340,859	$ 9,646,283

Donor restricted endowment funds consist of cash and investments and are held for the following purposes at December 31:

	2011	2010
Archives endowment	$ 723,687	$ 690,548
Lopez endowments	162,066	164,365
Graham endowment	260,925	256,301
McCord endowment	90,063	91,252
Panther endowment	29,719	29,388
Ostergaard endowment	79,442	69,844
	$ 1,345,902	$ 1,301,698

4. Net assets (continued):

Changes in endowment net assets for the years ended December 31, 2011 and 2010, are as follows:

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Endowment net assets, December 31, 2009	$ 7,230,637	$ 34,984	$ 1,274,156	$ 8,539,777
Contributions	104,306	--	66,703	171,009
Net investment income	100,558	4,198	--	104,756
Net realized and unrealized gains	816,434	507	--	816,941
Program expenses	--	(1,200)	--	(1,200)
Transfers between classes to offset investment losses	32,939	(32,939)	--	--
Transfers in	15,000	--	--	15,000
Endowment net assets, December 31, 2010	8,299,874	5,550	1,340,859	9,646,283
Contributions	19,384	--	60,186	79,570
Net investment income	145,048	4,276	--	149,324
Net realized and unrealized losses	(283,602)	(7,425)	--	(291,027)
Program expenses		(600)	--	(600)
Transfers in	15,000	--	--	15,000
Endowment net assets, December 31, 2011	$ 8,195,704	$ 1,801	$ 1,401,045	$ 9,598,550

5. Employee benefit plans:

Insurance Services administers a non-contributory, defined contribution retirement plan (the Defined Contribution Plan) for its employees. All employees who have attained the age of 21 and completed 1,000 hours of service during a 12-month period are eligible. The right to discontinue the Defined Contribution Plan has been reserved by Insurance Services, and in such event the trust fund must be used for the exclusive benefit of participants. Insurance Services' annual contribution to the Defined Contribution Plan is seven percent (7%) of each participant's annual salary. Additionally, Insurance Services has a 401(k) plan, under which Insurance Services matches employee contributions up to an additional four percent (4%) of compensation. Insurance Services contributed $80,675 and $89,333 to the plans for 2011 and 2010, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

YEARS ENDED DECEMBER 31, 2011 AND 2010

6. **Functional allocation of expenses:**

The costs of providing various program and supporting activities of the Foundation have been reported on a natural basis in the statement of activities. The costs of these activities on a functional basis, including allocation of certain costs, are summarized below.

	2011	2010
Program services	$ 4,629,965	$ 7,378,875
Supporting services:		
Administration	433,281	399,231
Fundraising	763,140	824,401
	1,196,421	1,223,632
	$ 5,826,386	$ 8,602,507

7. **Income taxes:**

Insurance Services' current federal and state income tax asset (liability) and deferred tax liability follow:

	2011	2010
Current tax asset (liability)	($ 25,331)	$ 4,226
Deferred tax asset	$ 28,232	$ 26,382
Deferred tax liability	(33,796)	(33,274)
Deferred tax liability, net	($ 5,564)	($ 6,892)

The provisions for income taxes consist of the following components:

	2011	2010
Current expense	$ 623,400	$ 593,568
Deferred expense (benefit)	(1,328)	2,728
	$ 622,072	$ 596,296

Insurance Services' provision for income taxes differs from applying the statutory U.S. federal income tax rate to income before income taxes primarily due to provisions for state income taxes and deducting certain expenses for financial statement purposes but not for federal income tax purposes.

8. Leases:

Insurance Services leases space from the Academy. The current lease expires in September 2014. Future minimum lease payments are as follows:

Year ending December 31,	Amount
2012	$ 84,342
2013	84,342
2014	56,227
	$ 224,911

Total rent expense for the office operating lease was $84,342 for the years ended December 31, 2011 and 2010, respectively.

9. Major customer and sole stockholder:

The Academy, as the contract holder, controls certain plans administered by Insurance Services. The Board of Directors of the Academy constitutes the membership of Insurance Services' sole stockholder, the American Academy of Family Physicians Foundation. Insurance Services administers Academy-sponsored life insurance plans and, pursuant to a royalty agreement related thereto, incurred costs to the Academy of $56,030 and $56,599 for the years ended December 31, 2011 and 2010, respectively.

10. Related-party transactions:

Foundation accounts receivable include revenues and other support from the Academy of $56,251 and $64,814 at December 31, 2011 and 2010, respectively. Accounts payable includes $351,632 and $897,023 at December 31, 2011 and 2010, respectively, due to the Academy by the Foundation for services and other items. In addition, $10,831 and $3,894 were due to the Academy from Insurance Services at December 31, 2011 and 2010, respectively, as reimbursements for certain common administrative costs.

Insurance Services reimbursed the Academy for common administrative costs (postage, internet, telephone) and marketing expenses in the amount of $100,324 and $121,284 for 2011 and 2010, respectively.

10. Related-party transactions (continued):

The following amounts were provided to the Foundation as support from, or pass-through donations collected by, the Academy for the years ended December 31:

	2011	2010
Dues check-off (pass-through donation)	$ 274,265	$ 281,300
Operational support		5,000
Center for the History of Family Medicine support	15,000	15,000
Other	39,740	45,000
	$ 329,005	$ 346,300

Effective January 1, 2011, the administrative services contract with the Academy changed so that all of the expenses incurred through the Academy are now considered direct expenses. The Foundation pays the direct expenses and an overhead rate of 22.2% on those expenses. During 2011 the Foundation incurred $1,721,067 of expenses and overhead for personnel, travel, postage, supplies, design, printing, rent and other program expenses. The Foundation incurred $1,809,790 for similar expenses during 2010 with part of it being paid as a set fee and some expenses billed as direct expenses. The Foundation also recorded $1,178,536 in 2011 and $2,068,400 in 2010 for grants and related costs to the Academy.

11. Conditional promises:

In May 2007, The Foundation entered into an agreement with Eli Lilly and Company Foundation, Inc. (Lilly) whereby Lilly agreed to a grant of $15 million to the Foundation to support the development of the "Peers for Progress" program (PFP). PFP is designed to help the diabetes community establish a new model of peer education for people with diabetes. The program is rooted in peer-to-peer interactions in order to sustain individual behavior changes that will improve health as well as quality of life. PFP is designed to demonstrate the value of peer support, extend the evidence base for such interventions, help establish peer support as an accepted, core component of diabetes care, and promote peer support programs and networks around the world.

In December 2010, the Foundation entered into a grant agreement with Bristol-Myers Squibb Foundation, Inc. that provides for a grant of up to $5,234,876, in three annual payments, in support of a demonstration project to be led by the PFP management team. The grant expires December 31, 2013.

These grants are cancellable by the grantors at any time with or without cause with unexpended or uncommitted advances to be refunded. The Foundation retains a 5% fee for administering the grants. Through December 31, 2011, the Foundation had received $18,293,433 under these grant agreements, and $13,070,181 in expenses had been incurred. The balance of $5,223,252 is included in deferred revenue at December 31, 2011.

12. Commitments:

On June 2, 2010, Insurance Services entered into a two-year employment contract with its president, effective July 1, 2010, and renewable automatically on a two-year basis subject to cancellation by either party under specified conditions. This contract provides for a base compensation including a fixed salary along with incentive compensation based on dividends paid.

On December 12, 2005, the Foundation entered into an administrative services contract with the Academy. Under the contract, for a monthly agreed-upon fee, the Academy agreed to perform day-to-day executive, legal, accounting, clerical and other services in connection with the operations of the Foundation. The contract, effective January 1, 2006 for a one-year term, was automatically extended for consecutive one-year periods through December 31, 2010. A new contract was entered into effective January 1, 2011 which provided for monthly reimbursement to the Academy for all expenses that go though the Academy including salaries and related costs, travel, supplies, postage, design, printing and other program expenses. Additionally, the Foundation pays the Academy a monthly overhead rate of 22.2% on the expenses reimbursed under the contract. The contract is effective for one year and automatically renews each year unless a 90-day notice of termination is given by either party.