CAROLINA FAMILY HEALTH CENTERS, INC.

Financial Statements, Compliance Reports and Supplemental Schedules

June 30, 2014 and 2013

(with Independent Auditors' Report thereon)

CAROLINA FAMILY HEALTH CENTERS, INC.

Table of Contents

June 30, 2014 and 2013

Page(s)

DIXON HUGHES GOODMAN LLP
Certified Public Accountants and Advisors

Independent Auditors' Report

To the Board of Directors
Carolina Family Health Centers, Inc.
Wilson, North Carolina

We have audited the accompanying financial statements of Carolina Family Health Centers, Inc. (a not-for-profit organization) (the "Center"), which comprise the balance sheets as of June 30, 2014 and 2013, and the related statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

2501 Blue Ridge Road, Suite 500, Raleigh, NC 27607 | T 919.876.4546 | F 919.876.8680 | dhgllp.com

To the Finance Committee
Carolina Family Health Centers, Inc.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Carolina Family Health Centers, Inc. as of June 30, 2014 and 2013, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of expenditures of federal and state awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic 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 financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the 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 is fairly stated, in all material respects, in relation to the financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated September 17, 2014, on our consideration of the Center's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Center's internal control over financial reporting and compliance.

Dixon Hughes Goodman LLP

September 17, 2014

CAROLINA FAMILY HEALTH CENTERS, INC.

Balance Sheets

June 30, 2014 and 2013

Assets	2014	2013
Current assets:		
Cash and cash equivalents	$ 777,292	$ 661,807
Restricted funds under loan agreement	312,781	77,108
Short-term investments	485,528	484,146
Patient accounts receivable, net of allowance for estimated uncollectible accounts of approximately $452,000 and $403,000 in 2014 and 2013, respectively	208,793	316,943
Estimated third-party payor settlements	56,205	30,012
Other receivables	111,669	216,727
Prepaid expenses and supplies	67,382	61,424
Inventory	180,259	151,653
Total current assets	2,199,909	1,999,820
Property and equipment, net	7,483,946	6,828,529
Total assets	$ 9,683,855	$ 8,828,349
Liabilities and Net Assets		
Current liabilities:		
Current installments of long-term debt	$ 173,906	$ 158,604
Accounts payable	425,798	159,499
Accrued expenses	695,954	650,462
Deferred revenue	41,675	30,819
Total current liabilities	1,337,333	999,384
Long-term debt, less current installments	4,029,052	4,110,596
Total liabilities	5,366,385	5,109,980
Net assets:		
Unrestricted	4,317,470	3,718,369
Total liabilities and net assets	$ 9,683,855	$ 8,828,349

CAROLINA FAMILY HEALTH CENTERS, INC.

Statements of Operations and Changes in Net Assets

For the Years Ended June 30, 2014 and 2013

	2014	2013
Unrestricted net assets:		
Unrestricted revenues, gains and other support:		
Net patient service revenue (net of contractual allowances and sliding fee scale adjustments)	$ 8,656,618	$ 8,545,407
Less provision for bad debts	49,277	5,411
Net patient service revenue less provision for bad debts	8,607,341	8,539,996
Grant revenue	5,627,530	5,185,572
Miscellaneous income	403,785	663,465
Investment income	2,483	3,388
Contributed services	215,900	205,600
Total unrestricted revenues, gains and other support	14,857,039	14,598,021
Expenses:		
Salaries and wages	7,346,562	6,902,413
Employee benefits	1,671,977	1,658,887
Contract services	989,715	1,345,938
Professional fees	138,828	128,145
Supplies	3,141,886	3,091,323
Facility	506,555	636,161
Travel	106,419	103,082
Utilities	110,078	111,644
Insurance	38,749	29,832
Telephone	109,470	95,727
Dues and subscriptions	27,171	43,310
Contributed services	215,900	205,600
Depreciation	464,414	470,181
Other	209,911	295,169
Total expenses	15,077,635	15,117,412
Excess of expenses over revenues	(220,596)	(519,391)
Grants and contributions for purchase of property and equipment	819,697	138,259
Change in net assets	599,101	(381,132)
Net assets, beginning of year	3,718,369	4,099,501
Net assets, end of year	$ 4,317,470	$ 3,718,369

CAROLINA FAMILY HEALTH CENTERS, INC.

Statements of Cash Flows

For the Years Ended June 30, 2014 and 2013

	2014	2013
Operating activities:		
Change in net assets	$ 599,101	$ (381,132)
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Provision for bad debts	49,277	5,411
Depreciation	464,414	470,181
Gain on the disposal of property and equipment	(40,721)	-
Grants and contributions for purchase of property and equipment	(819,697)	(138,259)
Net change in:		
Patient accounts receivable	58,873	(157,959)
Estimated third-party payor settlements	(26,193)	201,184
Other receivables	105,058	(105,094)
Prepaid expenses and supplies	(5,958)	21,718
Inventory	(28,606)	647
Accounts payable	69,339	(84,114)
Accrued expenses	45,492	140,405
Deferred revenue	10,856	(78,273)
Net cash provided by (used in) operating activities	481,235	(105,285)
Investing activities:		
Net change in short-term investments	(1,382)	(934)
Net (increase) decrease in restricted funds under loan agreement	(235,673)	39,649
Proceeds from the sale of property and equipment	51,080	-
Purchase of property and equipment	(933,230)	(223,115)
Net cash used in investing activities	(1,119,205)	(184,400)
Financing activities:		
Proceeds from issuance of long-term debt	93,500	-
Principal payments on long-term debt	(159,742)	(140,149)
Grants and contributions received for purchases of property and equipment	819,697	138,259
Net cash provided by (used in) financing activities	753,455	(1,890)
Net change in cash and cash equivalents	115,485	(291,575)
Cash and cash equivalents, beginning of year	661,807	953,382
Cash and cash equivalents, end of year	$ 777,292	$ 661,807
Supplemental disclosures of cash flow information:		
Cash paid for interest	$ 137,483	$ 174,411
Property and equipment additions in accounts payable	$ 196,960	$ -

1. **Description of Organization and Summary of Significant Accounting Policies**

Organization and Basic Program – Carolina Family Health Centers, Inc., (the "Center") a federally qualified community health center, is a not-for-profit tax-exempt organization under Internal Revenue Code 501(c)(3). The Center opened in Wilson, North Carolina in August 1994 and now operates additional sites in rural Nash and Edgecombe counties, North Carolina. In addition to basic primary care, the practice provides dental service, health education including special diabetes and HIV/AIDS programs, behavioral health, medication assistance and laboratory services.

Use of Estimates – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Contributed Services – Contributed professional services are recognized at fair value in the financial statements if the services received (a) create or enhance long-lived assets or (b) require specialized skills, and would typically need to be purchased if not provided by donation. During 2014 and 2013, the Center received services in its pharmacy from a pharmacist and student interns. The services were valued at approximately $216,000 and $206,000 for 2014 and 2013, respectively.

Cash and Cash Equivalents – For the purpose of reporting cash flows, the Center considers all short-term investments having a maturity at the date of purchase of three months or less to be cash equivalents. Throughout the year, the Center had bank balances in financial institutions that exceeded federal depository insurance limits.

Restricted Funds Under Loan Agreement – Restricted funds under loan agreement includes reserve funds required under the Center's U.S. Department of Agriculture ("USDA") Rural Development Loan. The reserve can be established in a single deposit equal to one year's debt service or in annual deposits equal to ten percent of the annual payment until the reserve has an amount equal to one year's debt service. The minimum amount required to be reserved at June 30, 2014 and 2013 is $86,317 and $73,986, respectively. Restricted funds above this amount will be used for annual debt service. Details regarding this loan are included at Note 4.

Short-Term Investments – Short-term investments include certificates of deposit which are recorded at historical cost. Investment income is included in the period earned in the change in unrestricted net assets unless the income is restricted by donor or law.

Property and Equipment – Property and equipment acquisitions are recorded at cost and donated property and equipment is recorded at fair market value at date of donation. Depreciation is provided over the estimated useful life of each class of depreciable assets, ranging from 3 to 39 years, and is computed using the straight-line method.

Inventory – Inventory is stated at the lower of cost (first-in, first-out method) or market.

Deferred Revenue – Deferred revenue is revenue received from various government agencies that has yet to be expended by the Center for the purpose stated within the agreement between the Center and the government agency.

Net Patient Service Revenue – The Center has agreements with third-party payors that provide for payments to the Center at amounts different from its established rates. Payment arrangements include fee for service, reimbursed costs, discounted charges and per visit payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered.

Provision for Bad Debts – During fiscal year 2013, the Center adopted FASB Accounting Standards Update ("ASU") 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provisions for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*. In conjunction with the adoption, the Center reclassified the provision for bad debts associated with patient service revenue from an operating expense to a deduction from patient service revenue (net of contractual allowances and discounts). Accordingly, the provision for bad debts is included as a component of net patient service revenue in the statements of operations for 2014 and 2013.

Sliding Fee Discount Program – The Center provides care to patients who meet certain criteria, based on official poverty guidelines issued by the Department of Health and Human Services, under its sliding fee discount program policy. This program reduces the amount that uninsured or under-insured patients must pay for services provided by the Center. These amounts are deducted from the gross charges in arriving at net patient service revenue. The amount of charges foregone for services and supplies furnished under the Center's sliding fee discount program aggregated approximately $4,088,000 and $4,531,000 for 2014 and 2013, respectively.

Use of Electronic Health Records (EHR) – The Center recognizes revenues for incentives earned under the Medicaid program in the period in which it is reasonably assured that it will comply with the applicable EHR meaningful use requirements. The maximum incentive payment amount that can be received under the Medicaid program is $63,750 per provider across 6 years of program participation. The EHR funding received is subject to Centers for Medicare & Medicaid Services audit. The Center achieved compliance with the Year 1 meaningful use requirements for nine providers under the Medicaid program during 2013 and, accordingly, recognized miscellaneous income of

$191,250 in the statements of operations for the year ended June 30, 2013 of which $148,750 was received from Medicaid during 2013 with the remaining $42,500 included within other receivables on the balance sheet. During 2014, the center achieved compliance with Year 1 meaningful use requirements for two additional providers and accordingly recognized income of $42,500 as miscellaneous income in the statements of operations for the year ended June 30, 2014. At June 30, 2014 $21,500 remained in other receivables on the balance sheet.

Patient Accounts Receivable, Net – Patient accounts receivable are reported at estimated net realizable amounts from patients and responsible third-party payors. Amounts owed to the Center are reported net of estimated allowances for uncollectible accounts. Specific patient balances are written off at the time they are determined to be uncollectible. The process for estimating the ultimate collection of patient receivables involves significant assumptions and judgments. In this regard, the Center has implemented a standardized approach to estimate and review the collectability of its receivables based on patient accounts receivable aging trends. Historical collection and payer reimbursement experience are an integral part of the estimation process related to determining allowances for uncollectible accounts. In addition, the Center assesses the current state of its billing functions in order to identify any reserve estimates, which involve judgment. Revisions to reserve estimates are recorded as adjustments to the provision for bad debt. The Center believes that its collection and reserves processes, along with the monitoring of its billing processes, help to reduce the risk associated with material revisions to reserve estimates resulting from adverse changes in collection, reimbursement experience and billing functions.

Excess of Expenses Over Revenues – The statements of operations and changes in net assets includes excess of expenses over revenues. Changes in net assets that are excluded from excess of expenses over revenues, consistent with industry practice, are contributions of long-lived assets (including assets acquired using contributions that by donor restriction were to be used for the purpose of acquiring such assets).

Income Taxes – The Center is a tax-exempt organization as described in Section 501(c)(3) of the Internal Revenue Code; accordingly, the accompanying financial statements do not reflect a provision or liability for federal and state income taxes. The Center has determined that it does not have any material unrecognized tax benefits or obligations as of June 30, 2014. The Center believes it is no longer subject to income tax examinations for years prior to June 30, 2011.

Subsequent Events – The Center evaluated the effect subsequent events would have on the financial statements through September 17, 2014, which is the date the financial statements were available to be issued.

2. Net Patient Service Revenue and Patients Accounts Receivable

Net patient service revenue and accounts receivable are recorded when patient services are performed and are estimated at net realizable amounts due from third-party payors and patients. For amounts due from third-party payors, net patient service revenue and accounts receivables are recorded based on contractual or regulated discounted reimbursement rates for services rendered. For amounts due from patients, net patient service revenue and accounts receivable are recorded based on current policy. During 2012, the Center switched to a new accounts receivable system. During 2013 the Center wrote off all old accounts from the previous billing system and removed additional amounts for estimated uncollectible accounts that were added during 2012 due to the switch in accounts receivable system. As noted in note 7, the 2014 gross accounts receivable balance includes a higher proportion of patient balances, which are reserved at a higher percentage than other concentrations of accounts receivable leading to a higher percentage for the reserve for uncollectible accounts at June 30, 2014.

The use of estimates in determining net patient service revenue for third-party payers is very common for health care providers, since, with increasing frequency, even non-cost-based governmental programs have become subject to retrospective adjustments. Often such adjustments are not known for a considerable period of time after the related services are rendered. The lengthy period of time between rendering services and reaching final settlement, compounded further by the complexities and ambiguities of governmental reimbursement regulations, makes it difficult to estimate the net patient service revenue associated with these programs. This situation has been compounded by the frequency of changes in federal program guidelines.

A summary of the payment arrangements with major third-party payors follows:

- *Medicare* – Services rendered to Medicare program beneficiaries are reimbursed in accordance with Federally Qualified Health Center Regulations as published in CMS-Pub. 27. A retrospective cost based reimbursement methodology is used for care visit services paid through a fiscal intermediary. Reimbursable other ancillary services are paid on a fee for services basis and are administered by an insurance carrier. The Center's Medicare cost reports have been desk reviewed by the fiscal intermediary through June 30, 2013.

- *Medicaid* – Services rendered to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology. The Center is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by the Center and audits thereof by the Medicaid fiscal intermediary. The Center's Medicaid cost reports have been desk reviewed by the North Carolina Medicaid program through June 30, 2013.

Revenue from the Medicare program accounted for approximately 7% of the Center's net patient service revenue for both years ended 2014 and 2013. Revenue from the Medicaid program accounted for approximately 19% and 20% of the Center's net patient service revenue for the years ended 2014 and 2013, respectively.

Under the Medicare and Medicaid programs, the Center is entitled to reimbursements for certain patient charges at rates determined by federal and state governments. Differences between established billing rates and reimbursements from these programs are recorded as contractual adjustments to arrive at net patient service revenue. Final determination of amounts due from Medicare and Medicaid programs is subject to review by these programs. Changes resulting from final determination are reflected as changes in estimates, generally in the year of determination. In the opinion of management, adequate provision has been made for adjustment, if any, that may result from such reviews. Net patient service revenue was decreased by approximately $41,000 and increased by approximately $130,000 for the years 2014 and 2013, respectively, as a result of changes in estimates associated with settlements and other revisions to prior years for third-party payor settlement accounts.

For uninsured and underinsured patients that do not qualify for financial assistance, the Center recognizes revenue on the basis of its standard rates, discounted according to policy, for services rendered. Historical experience has shown a significant proportion of the Center's uninsured patients, in addition to a growing proportion of the Center's insured patients, will be unable or unwilling to pay for their responsible amounts for the services provided. In order to estimate the net realizable value of the revenues and accounts receivables associated with third-party payers and uninsured patients, management regularly analyzes collection history. Based on these historical collection analyses, the Center records a provision for bad debts and an allowance for estimated uncollectible accounts for third-party and uninsured patient accounts receivable balances for which the patient is responsible. The allowance for estimated uncollectible accounts decreased significantly in 2013 due to the write-off of a significant amount of older balances related to an accounts receivable system that was phased out during 2012. The allowance for estimated uncollectible accounts as a percentage of the gross accounts receivable related to the new accounts receivable system was decreased due to additional collection history. During 2014, with two full years of using the new accounts receivable system, the concentration of accounts receivable balances returned back to normal, leading to higher patient balances which are more difficult to collect, thus leading to a higher overall percentage reserve for uncollectible accounts at June 30, 2014.

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. The Center believes that they are in compliance with all applicable laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action including fines, penalties and exclusion from the Medicare and Medicaid programs.

As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

Patient service revenue, net of contractual allowances and sliding fee scale adjustments (but before the provision for bad debts), is composed of the following approximate amounts for the years ended June 30:

	2014	2013
Medicare and Medicaid programs	$ 2,302,954	$ 2,226,229
Other third-party payors	4,520,396	4,361,726
Self-pay	1,833,268	1,957,452
Patient service revenue (net of contractual allowances and sliding fee scale adjustments)	$ 8,656,618	$ 8,545,407

3. **Property and Equipment**

A summary of property and equipment at June 30 follows:

	2014	2013
Land	$ 400,457	$ 368,458
Buildings and building improvements	7,222,997	7,140,600
Equipment	1,436,921	1,531,465
Furniture and fixtures	50,082	50,082
Construction in progress	1,156,918	149,975
	10,267,375	9,240,580
Less accumulated depreciation	(2,783,429)	(2,412,051)
Property and equipment, net	$ 7,483,946	$ 6,828,529

The center had remaining commitments to complete construction of renovations of approximately $2,220,000 at June 30, 2014.

4. **Long-Term Debt**

A summary of long-term debt at June 30 follows:

	2014	2013
Mortgage payable with a financial institution, monthly payments of $8,823, including interest at 3.95% maturing December 2024, secured by deed of trust.	$ 904,874	$ 974,496
Note payable to a financial institution, monthly payments of $2,209, including interest at 6.25%, maturing November 2015, unsecured.	33,803	57,686
Mortgage payable to the USDA, annual payments of $123,312, including interest at 4.125%, payable over 30 years, maturing May 2038, secured by deed of trust.	1,807,337	1,854,070
Mortgage payable to the USDA, annual payments of $64,302 of principal and interest at 3.375%, payable over 40 years with final payment due April 2052, secured by deed of trust.	1,365,330	1,382,948
Mortgage payable to a financial institution, annual payments of $953 of principal and interest at 4.15% payable over 10 years with final payment due April 2024, secured by deed of trust.	91,614	-
	4,202,958	4,269,200
Less current installments	(173,906)	(158,604)
	$ 4,029,052	$ 4,110,596

Scheduled principal payments on long-term debt are as follows:

Year ending June 30,	
2015	$ 173,906
2016	157,850
2017	157,945
2018	164,243
2019	170,795
Thereafter	3,378,219
	$ 4,202,958

5. Medical Malpractice Claims

The Center is insured under Section 224(a) of the Public Health Act, 42 U.S.C. 233 (L) as amended by the Federally Supported Health Centers Assistance Act of 1995. Section 224(a) provides liability protection under the Federal Tort Claims Act for damage for personal injury, including death, resulting from the performance of medical, surgical, dental and related functions. The coverage is comparable to an occurrence policy and has no monetary cap.

6. Retirement Plan

The Center maintains a 403(b) plan for all full-time employees. Employees can contribute the maximum allowed by federal law and the Center provides a matching contribution of up to 3% of each employee's compensation. The Center will provide up to an additional 1% contribution for those employees who contribute between 3% and 5% of their compensation. Total contributions to the plan were approximately $181,000 in 2014 and $180,000 in 2013.

7. Concentrations of Credit Risk

The Center grants credit without collateral to its patients, most of whom are local residents and are partially insured under third-party payor agreements. The mix of receivables from patients and third-party payors follows at June 30:

	2014	2013
Medicare	17%	29%
Medicaid	9%	13%
Private insurance	24%	23%
Patients	50%	35%
	100%	100%

8. Operating Leases

The Center is obligated under non-cancelable operating leases for certain administrative facilities and equipment. Total rent and lease expense for 2014 and 2013 was approximately $69,000 and $52,000, respectively.

The Center has minimum lease obligations as follows for the year ending June 30:

2015	$ 53,560
2016	52,883
2017	52,440
2018	52,440
2019	31,542
Total	$ 242,865

9. Functional Expenses

The Center provides general health, dental and pharmaceutical services to residents within its geographic location. Expenses related to providing these services are as follows for the years ended June 30:

	2014	2013
Health care services	$ 13,603,079	$ 13,661,963
General and administrative	1,474,556	1,455,449
	$ 15,077,635	$ 15,117,412

10. Contingencies

The Center has received proceeds from several federal and state grants. These amounts are subject to additional audit procedures in accordance with federal and state regulations. Certain costs charged to the grants may be questioned as not being appropriate expenses under the grant agreements. Any questioned costs could result in the refund of grant monies to grantor agencies. Management expects such amounts, if any, to be immaterial.

Independent Auditors' Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

To the Finance Committee
Carolina Family Health Centers, Inc.

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Carolina Family Health Centers, Inc. (the "Center") as of and for the years ended June 30, 2014 and 2013, and the related notes to the financial statements, and have issued our report thereon dated September 17, 2014.

Internal Control over Financial Reporting

In planning and performing our audits, we considered the Center's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Center's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Center's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or, significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

2501 Blue Ridge Road, Suite 500, Raleigh, NC 27607 | T 919.876.4546 | F 919.876.8680 | dhgllp.com

To the Finance Committee
Carolina Family Health Centers, Inc.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Center's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, non-compliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Center's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Center's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Dixon Hughes Goodman LLP

September 17, 2014

Independent Auditors' Report on Compliance for each Major Program and on Internal Control over Compliance Required by OMB Circular A-133

To the Finance Committee
Carolina Family Health Centers, Inc.

Report on Compliance for Each Major Federal Program

We have audited Carolina Family Health Centers, Inc. (the "Center") compliance with the types of compliance requirements described in *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Center's major federal programs for the year ended June 30, 2014. The Center's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on the Center's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Center's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the Center's compliance.

2501 Blue Ridge Road, Suite 500, Raleigh, NC 27607 | T 919.876.4546 | F 919.876.8680 | dhgllp.com

To the Finance Committee
Carolina Family Health Centers, Inc.

Opinion on Each Major Federal Program

In our opinion, the Center complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2014.

Report on Internal Control Over Compliance

Management of the Center is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Center's internal control over compliance with the requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Center's internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Dixon Hughes Goodman LLP

September 17, 2014

CAROLINA FAMILY HEALTH CENTERS, INC.
Schedule of Expenditures of Federal and State Awards
For the Year Ended June 30, 2014

Grantor/ Program or Cluster Title	Federal CFDA/ Contract Number	Expenditures
Federal Awards:		
U.S. Department of Health and Human Services:		
Health Centers Cluster	93.224 93.527	$ 4,572,778
Grants to Provide Outpatient Early Intervention Services with Respect to HIV Disease	93.918	553,329
Large Capital Community Health Grant (May 1, 2012 – April 30, 2015)	93.526	819,697
Passed through North Carolina Department of Health and Human Services:		
Division of Public Health		
HIV Care Formula Grant (Ryan White Part B) (April 1, 2013 - March 31, 2015)*	93.917	330,091
Care and Prevention in the United States (January 1, 2014 - September 29, 2014)**	93.940	22,692
Total Department of Health and Human Services		6,298,587
U.S. Department of Housing and Urban Development:		
Passed through North Carolina Department of Health and Human Services:		
Housing Opportunities for Persons with AIDs (June 1, 2013 - May 31, 2016)***	14.241	114,439
Total Federal Awards		6,413,026
State Award:		
North Carolina Department of Health and Human Services:		
Office of Rural Health and Community Care		
Medication Assistance Program Grants - (August 1, 2012 – July 31, 2014)	#27547 #29638	34,201
Total Federal and State Awards		$ 6,447,227

* Contract ID #'s 26259 and 28068
** Contract ID #'s 28298 and 30335
***Contract ID # 29589

CAROLINA FAMILY HEALTH CENTERS, INC.

Note to Schedule of Expenditures of Federal and State Awards

For the Year Ended June 30, 2014

Note 1. Basis of Presentation

The accompanying schedule of expenditures of federal and state awards includes the federal and state grant activity of Carolina Family Health Centers, Inc. and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations.*

CAROLINA FAMILY HEALTH CENTERS, INC.

Schedule of Findings and Questioned Costs

For the Year Ended June 30, 2014

Section I--Summary of Auditors' Results

Financial Statements

Type of auditors' report issued: Unqualified

Internal control over financial reporting:

• Material weakness(es) identified?	_____ yes	X	no
• Significant deficiency(ies) identified that are not considered to be material weaknesses?	_____ yes	X	none reported
Noncompliance material to financial statements noted?	_____ yes	X	no

Federal Awards

Internal control over major federal program:			
• Material weakness(es) identified?	_____ yes	X	no
• Significant deficiency(ies) identified that are not considered to be material weaknesses?	_____ yes	X	none reported
Noncompliance material to federal awards	_____ yes	X	no

Type of auditors' report issued on compliance for major program: Unqualified

Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of Circular A-133?	_____ yes	X	no

CAROLINA FAMILY HEALTH CENTERS, INC.

Schedule of Findings and Questioned Costs, continued

For the Year Ended June 30, 2014

Section I--Summary of Auditors' Results, Continued

Identification of major federal programs:

CFDA Number	*Name of Federal Program or Cluster*
93.224 & 93.527	Health Centers Cluster
93.917	HIV Care Formula Grant (Ryan White Part B)
93.526	Large Capital Community Health Grant
14.241	Housing Opportunities for Persons with AIDs

Dollar threshold used to distinguish between Type A and Type B programs: $300,000

Auditee qualified as low-risk auditee? X yes _____ no

CAROLINA FAMILY HEALTH CENTERS, INC.

Schedule of Findings and Questioned Costs, continued

For the Year Ended June 30, 2014

Section II—Financial Statement Findings

No matters are reportable.

Section III—Federal Award Findings and Questioned Costs

No matters are reportable.