

Community Health Care, Inc.

Accountants' Reports and Financial Statements

January 31, 2012 and 2011

Community Health Care, Inc.
January 31, 2012 and 2011

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Independent Accountants' Report on Financial Statements and Supplementary Information

Board of Directors
Community Health Care, Inc.
Davenport, Iowa

We have audited the accompanying balance sheets of Community Health Care, Inc. (the "Organization") as of January 31, 2012 and 2011, and the related statements of operations, changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the 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 provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Community Health Care, Inc. as of January 31, 2012 and 2011, and the results of its operations, the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 28, 2012, on our consideration of the Organization's internal control over financial reporting and 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of expenditures of federal awards required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, as listed in the table of contents, is presented for purposes of additional analysis and is not a required part of the 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.

BKD, LLP

August 28, 2012

Community Health Care, Inc.

Balance Sheets

January 31, 2012 and 2011

Assets

	<u>2012</u>	<u>2011</u>
Current Assets		
Cash and cash equivalents	\$ 172,307	\$ 520,958
Assets limited as to use - current	120,941	120,587
Patient accounts receivable, net of allowance; 2012 - \$1,606,401, 2011 - \$1,281,401	2,177,286	2,120,559
Grants and other receivables	677,986	90,604
Contributions receivable - current	134,765	244,765
Estimated amounts due from third-party payers	300,000	-
Inventories	129,051	148,929
Prepaid expenses and other	155,180	122,851
	<u>3,867,516</u>	<u>3,369,253</u>
Assets Limited as to Use - Externally Restricted	<u>267,706</u>	<u>207,644</u>
Property and Equipment, At Cost		
Land	1,280,265	1,280,265
Buildings and leasehold improvements	13,930,173	12,388,053
Equipment	5,188,036	4,354,050
Construction in progress	267,078	46,351
	<u>20,665,552</u>	<u>18,068,719</u>
Less accumulated depreciation	<u>7,223,480</u>	<u>6,861,050</u>
	<u>13,442,072</u>	<u>11,207,669</u>
Other Assets		
Deferred financing costs	<u>36,005</u>	<u>41,135</u>
	<u>36,005</u>	<u>41,135</u>
Total assets	<u><u>\$ 17,613,299</u></u>	<u><u>\$ 14,825,701</u></u>

Liabilities and Net Assets

	<u>2012</u>	<u>2011</u>
Current Liabilities		
Current maturities of long-term debt	\$ 472,708	\$ 375,961
Accounts payable	2,072,225	1,195,828
Accrued expenses	895,809	830,924
Deferred grant revenue	278,227	300,504
Estimated amounts due to third-party payers	-	200,000
	<u>3,718,969</u>	<u>2,903,217</u>
Lease Expense Payable	126,309	41,182
Long-Term Debt	<u>3,749,115</u>	<u>4,089,141</u>
Total liabilities	<u>7,594,393</u>	<u>7,033,540</u>
Net Assets		
Unrestricted	9,884,141	7,547,396
Temporarily restricted	<u>134,765</u>	<u>244,765</u>
Total net assets	<u>10,018,906</u>	<u>7,792,161</u>
Total liabilities and net assets	<u>\$ 17,613,299</u>	<u>\$ 14,825,701</u>

Community Health Care, Inc.
Statements of Operations
Years Ended January 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Unrestricted Revenues, Gains and Other Support		
Net patient service revenue	\$ 15,592,666	\$ 14,720,160
Grant revenue	4,416,620	3,971,752
Contributions and other	537,900	444,681
Net assets released from restrictions used for operations	<u>110,000</u>	<u>189,661</u>
Total unrestricted revenues, gains and other support	<u>20,657,186</u>	<u>19,326,254</u>
Expenses and Losses		
Salaries and wages	11,471,366	10,487,910
Employee benefits	1,272,504	1,166,925
Self-insured health insurance	966,234	1,010,735
Purchased services and professional fees	1,782,855	1,554,812
Supplies and other	3,213,150	3,056,700
Rent	365,039	303,619
Depreciation and amortization	841,014	828,252
Interest	223,796	230,739
Provision for uncollectible accounts	<u>1,199,345</u>	<u>1,175,510</u>
Total expenses and losses before loss on disposal of property and equipment	<u>21,335,303</u>	<u>19,815,202</u>
Operating Loss before Loss on Disposal of Property and Equipment	(678,117)	(488,948)
Loss on disposal of property and equipment	<u>1,339,615</u>	<u>-</u>
Operating Loss	(2,017,732)	(488,948)
Investment Return	<u>3,348</u>	<u>1,984</u>
Deficiency of Revenues over Expenses	(2,014,384)	(486,964)
Grants for acquisition of property and equipment	4,214,690	473,442
Contributions for acquisition of property and equipment	<u>136,439</u>	<u>-</u>
Increase (Decrease) in Unrestricted Net Assets	<u>\$ 2,336,745</u>	<u>\$ (13,522)</u>

Community Health Care, Inc.
Statements of Changes in Net Assets
Years Ended January 31, 2012 and 2011

	2012	2011
Unrestricted Net Assets		
Deficiency of revenues over expenses	\$ (2,014,384)	\$ (486,964)
Grants for acquisition of property and equipment	4,214,690	473,442
Contributions for acquisition of property and equipment	136,439	-
Increase (decrease) in unrestricted net assets	2,336,745	(13,522)
Temporarily Restricted Net Assets		
Net assets released from restriction	(110,000)	(189,661)
Decrease in temporarily restricted net assets	(110,000)	(189,661)
Change in Net Assets	2,226,745	(203,183)
Net Assets, Beginning of Year	7,792,161	7,995,344
Net Assets, End of Year	\$ 10,018,906	\$ 7,792,161

Community Health Care, Inc.
Statements of Cash Flows
Years Ended January 31, 2012 and 2011

	2012	2011
Operating Activities		
Change in net assets	\$ 2,226,745	\$ (203,183)
Items not requiring (providing) operating cash		
Loss on disposal of property and equipment	1,339,615	-
Depreciation and amortization	841,014	828,252
Contributions for acquisition of property and equipment	(136,439)	-
Grants for acquisition of property and equipment	(4,214,690)	(473,442)
Changes in		
Patient accounts receivable, net	(56,727)	(441,719)
Grants receivable	(587,382)	(32,978)
Contributions receivable	110,000	189,661
Estimated amounts due to and due from third-party payers	(500,000)	300,000
Accounts payable and accrued expenses	303,458	206,185
Other long-term liabilities	85,127	41,182
Deferred grant revenue	(22,277)	298,501
Other current assets and liabilities	(12,451)	(82,828)
	(624,007)	629,631
Net cash provided by (used in) operating activities		
Investing Activities		
Acquisition of assets limited as to use	(60,416)	-
Purchase of property and equipment	(3,772,078)	(592,640)
	(3,832,494)	(592,640)
Net cash used in investing activities		
Financing Activities		
Proceeds from contributions for acquisition of property and equipment	136,439	-
Proceeds from grants for acquisition of property and equipment	4,214,690	473,442
Proceeds from issuance of long-term debt	-	17,139
Principal payments on long-term debt	(243,279)	(326,022)
	4,107,850	164,559
Net cash provided by financing activities		
Increase (Decrease) in Cash and Cash Equivalents	(348,651)	201,550
Cash and Cash Equivalents, Beginning of Year	520,958	319,408
Cash and Cash Equivalents, End of Year	\$ 172,307	\$ 520,958
Supplemental Cash Flows Information		
Interest paid	\$ 223,708	\$ 229,651
Accounts payable incurred for property and equipment	\$ 678,650	\$ 40,826

Community Health Care, Inc.
Notes to Financial Statements
January 31, 2012 and 2011

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

Community Health Care, Inc. (the "Organization") is a community health center which provides health care, dental and education services to patients. The Organization primarily earns revenues by providing physician, dental and related health care services through clinics located in Scott County, Iowa, and Rock Island County, Illinois.

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.

Cash and Cash Equivalents

The Organization considers all liquid investments, other than those limited as to use, with original maturities of three months or less to be cash equivalents. At January 31, 2012 and 2011, cash equivalents consisted primarily of money market deposit accounts.

Effective July 21, 2010, the FDIC's insurance limits permanently increased to \$250,000. At January 31, 2012, the Organization's cash accounts did not exceed federally insured limits.

Pursuant to legislation enacted in 2010, the FDIC will fully insure all noninterest-bearing transaction accounts beginning December 31, 2010, through December 31, 2012, at all FDIC-insured institutions.

Investment Return

Investment return is comprised of interest income.

Assets Limited as to Use

Assets limited as to use include unrestricted assets set aside by the Board of Directors for future capital improvements and operating expenses over which the Board retains control and may at its discretion subsequently use for other purposes. Assets limited as to use also include externally restricted assets held under debt agreements. Amounts required or available to meet current liabilities of the Organization are included in current assets.

Community Health Care, Inc.
Notes to Financial Statements
January 31, 2012 and 2011

Patient Accounts Receivable

The Organization reports patient accounts receivable for services rendered at estimated net realizable amounts from third-party payers, patients and others. The Organization provides an allowance for doubtful accounts based upon a review of outstanding receivables, historical collection information and existing economic conditions. As a service to the patient, the Organization bills third-party payers directly and bills the patient when the patient's liability is determined. Patient accounts receivable are due in full when billed. Accounts are considered delinquent and subsequently written off as bad debts based on individual credit evaluation and specific circumstances of the account.

Inventory

The Organization states inventories at the lower of cost, determined using the first-in, first-out method, or market.

Property and Equipment

Property and equipment acquisitions are recorded at cost and are depreciated on a straight-line basis over the estimated useful life of each asset. Assets under capital lease obligations and leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives.

Certain property and equipment have been purchased with grant funds received from the U.S. Department of Health and Human Services. Such items may be reclaimed if not used to further the grant's objectives.

Donations of property and equipment are reported at fair value as an increase in unrestricted net assets unless use of the assets is restricted by the donor. Monetary gifts that must be used to acquire property and equipment are reported as restricted support. The expiration of such restrictions is reported as an increase in unrestricted net assets when the donated asset is placed in service.

Long-Lived Asset Impairment

The Organization evaluates the recoverability of the carrying value of long-lived assets whenever events or circumstances indicate the carrying amount may not be recoverable. If a long-lived asset is tested for recoverability and the undiscounted estimated future cash flows expected to result from the use and eventual disposition of the asset is less than the carrying amount of the asset, the asset cost is adjusted to fair value and an impairment loss is recognized as the amount by which the carrying amount of a long-lived asset exceeds its fair value.

No asset impairment was recognized during the years ended January 31, 2012 and 2011.

Community Health Care, Inc.

Notes to Financial Statements

January 31, 2012 and 2011

Deferred Financing Costs

Deferred financing costs represent costs incurred in connection with the issuance of long-term debt. Such costs are being amortized over the term of the respective debt using the straight-line method.

Temporarily Restricted Net Assets

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

Net Patient Service Revenue

The Organization has agreements with third-party payers that provide for payments to the Organization at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered and includes estimated retroactive revenue adjustments. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such estimated amounts are revised in future periods as adjustments become known.

Contributions

Unconditional gifts expected to be collected within one year are reported at their net realizable value. Unconditional gifts expected to be collected in future years are initially reported at fair value determined using the discounted present value of estimated future cash flows technique. The resulting discount is amortized using the level-yield method and is reported as contribution revenue.

Gifts received with donor stipulations are reported as either temporarily or permanently restricted support. When a donor restriction expires, that is, when a time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified and reported as an increase in unrestricted net assets. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions. Conditional contributions are reported as liabilities until the condition is eliminated or the contributed assets are returned to the donor.

Government Grants

Support funded by grants is recognized as the Organization performs the contracted services or incurs outlays eligible for reimbursement under the grant agreements. Grant activities and outlays are subject to audit and acceptance by the granting agency and, as a result of such audit, adjustments could be required.

Community Health Care, Inc.

Notes to Financial Statements

January 31, 2012 and 2011

In-Kind Contributions

The Organization receives in-kind contributions of pharmacy supplies. It is the policy of the Organization to record the estimated fair value of these in-kind donations as contribution revenue when received and pharmacy expense when used. During the years ended January 31, 2012 and 2011, \$244,368 and \$226,534, respectively, was received in in-kind contributions of pharmacy supplies.

Income Taxes

The Organization has been recognized as exempt from income taxes under Section 501 of the Internal Revenue Code and a similar provision of state law. However, the Organization is subject to federal income tax on any unrelated business taxable income.

Deficiency of Revenues Over Expenses

The statements of operations include deficiency of revenues over expenses. Changes in unrestricted net assets which are excluded from deficiency of revenues over expenses, consistent with industry practice, include unrealized gains and losses on investments other than trading securities, permanent transfers to and from affiliates for other than goods and services and contributions and grants of long-lived assets (including assets acquired using contributions or grants which by donor or granting agency restriction were to be used for the purpose of acquiring such assets).

Self-Insurance

The Organization has elected to self-insure certain costs related to employee health and accident benefit programs. Costs resulting from noninsured losses are charged to income when incurred.

Electronic Health Records Incentive Program

The Electronic Health Records Incentive Program, enacted as part of the *American Recovery and Reinvestment Act of 2009*, provides for one-time incentive payments under both the Medicare and Medicaid programs to eligible health centers that demonstrate meaningful use of certified electronic health records technology (EHR). Payments under the Medicare program are generally made for up to four years based on a statutory formula. Payments under the Medicaid program are generally made for up to four years based upon a statutory formula, as determined by the state, which is approved by the Centers for Medicare and Medicaid Services. Payment under both programs are contingent on the health center continuing to meet escalating meaningful use criteria and any other specific requirements that are applicable for the reporting period. The final amount for any payment year is determined based upon an audit by the fiscal intermediary. Events could occur that would cause the final amounts to differ materially from the initial payments under the program.

Community Health Care, Inc.

Notes to Financial Statements

January 31, 2012 and 2011

The Organization recognizes revenue ratably over the reporting period starting at the point when management is reasonably assured it will meet all of the meaningful use objectives and any other specific grant requirements applicable for the reporting period.

In 2012, the Organization completed the first-year requirements under both the Medicare and Medicaid programs and has recorded revenue of approximately \$446,250, which is included in grant revenue within operating revenues in the statements of operations.

Subsequent Events

Subsequent events have been evaluated through August 28, 2012, which is the date the financial statements were available to be issued.

Note 2: Grant Revenue

The Organization is the recipient of a Consolidated Health Centers (CHC) grant from the U.S. Department of Health and Human Services. The general purpose of the grant is to provide expanded health care service delivery for residents of Scott County, Iowa, and Rock Island County, Illinois. Terms of the grant generally provide for funding of the Organization's operations based on an approved budget. Grant revenue is recognized as qualifying expenditures are incurred over the grant period. During the years ended January 31, 2012 and 2011, the Organization received \$3,076,014 and \$2,888,741 in CHC grant funds, respectively.

The Organization has received a notice of grant award for an amount of \$3,076,014 for the year ended January 31, 2013.

In response to the current economic conditions, the federal government passed legislation appropriating grant dollars to community health centers under the American Recovery and Reinvestment Act (ARRA). The Organization has been awarded \$459,742 under the Increased Demand for Services (IDS) grant for the period of March 27, 2009, to March 26, 2011, to assist in meeting the needs of the community and \$1,301,050 under the Capital Improvement Program (CIP) grant for the period of June 29, 2009, to June 28, 2011, for facility improvements and equipment. Grant revenue is recognized as qualifying expenditures are incurred over the grant periods. During the year ended January 31, 2012, the Organization recognized \$0 in IDS grant revenue and \$49,998 in CIP grant revenue. During the year ended January 31, 2011, the Organization recognized \$141,303 in IDS grant revenue and \$426,282 in CIP grant revenue.

The Organization has also been awarded \$9,637,646 under the Affordable Care Act (ACA) for the October 1, 2010, to September 31, 2012, period to construct three new facilities. Grant revenue is recognized as qualifying expenditures are incurred over the grant period. The Organization recognized \$3,949,040 and \$46,351 in ACA grant revenue during the years ended January 31, 2012 and 2011, respectively.

Community Health Care, Inc.

Notes to Financial Statements

January 31, 2012 and 2011

In addition to these grants, the Organization receives additional financial support from other federal, state and private sources. Generally, such support requires compliance with terms and conditions specified in grant agreements and must be renewed on an annual basis.

Note 3: Net Patient Service Revenue

The Organization is approved as a Federally Qualified Health Center (FQHC) for both Medicare and Medicaid reimbursement purposes. The Organization has agreements with third-party payers that provide for payments to the Organization at amounts different from its established rates.

Medicare. Covered FQHC services rendered to Medicare program beneficiaries are paid based on a cost reimbursement methodology. The Organization is reimbursed for cost reimbursable items at tentative rates with final settlement determined after submission of an annual cost report by the Organization and audit thereof by the Medicare fiscal intermediary. Services not covered under the FQHC benefit are paid based on established fee schedules.

Iowa Medicaid. Covered FQHC services rendered to Iowa Medicaid program beneficiaries are paid based on a cost reimbursement methodology. The Organization is reimbursed for cost reimbursable services at tentative rates with final settlement determined after submission of an annual cost report by the Organization and audit thereof by the Medicaid fiscal intermediary.

Illinois Medicaid. Covered FQHC services rendered to Illinois Medicaid program beneficiaries are paid based on a prospective reimbursement methodology. The Organization is reimbursed a set encounter rate for all services provided under the plan.

Approximately 55% and 51% of net patient service revenue is from participation in the Medicare and state-sponsored Medicaid programs for the years ended January 31, 2012 and 2011, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

The Organization has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the Organization under these agreements includes prospectively determined rates per unit of service and discounts from established charges.

Community Health Care, Inc.

Notes to Financial Statements

January 31, 2012 and 2011

Note 4: Concentration of Credit Risk

The Organization grants credit without collateral to its patients, most of whom are area residents and are insured under third-party payer agreements. The mix of receivables from patients and third-party payers at January 31, 2012 and 2011, is:

	2012	2011
Medicare	10%	8%
Medicaid	60%	61%
Other third-party payers	30%	31%
	100%	100%

Note 5: Assets Limited as to Use

Assets limited as to use include:

	2012	2011
Internally designated - current		
Cash and cash equivalents	\$ 45,861	\$ 45,507
Certificates of deposit	75,080	75,080
	\$ 120,941	\$ 120,587
Externally restricted by debt agreement		
Cash equivalents	\$ 213,408	\$ 153,346
Certificates of deposit	54,298	54,298
	\$ 267,706	\$ 207,644

Note 6: Medical Malpractice Claims

The U.S. Department of Health and Human Services has deemed the Organization and its practicing physicians covered under the Federal Tort Claims Act (FTCA) for damage for personal injury, including death, resulting from the performance of medical, surgical, dental and related functions. FTCA coverage is comparable to an occurrence policy without a monetary cap. Accounting principles generally accepted in the United States of America require a health care provider to accrue the expense of malpractice claim costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate costs of the incidents. Based upon the Organization's claim experience, no such accrual has been made. It is reasonably possible that this estimate could change materially in the near term.

Community Health Care, Inc.
Notes to Financial Statements
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Note 7: Long-Term Debt

	2012	2011
Revenue bonds, Series 2003 (A)	\$ 1,248,645	\$ 1,350,679
Revenue bonds, Series 2007 (B)	1,671,072	1,671,072
Installment note payable (C)	-	53,333
Installment note payable (D)	515,031	564,431
Installment note payable (E)	787,075	825,587
	4,221,823	4,465,102
Less current maturities	472,708	375,961
	\$ 3,749,115	\$ 4,089,141

- (A) Series 2003 Revenue Bonds (the “2003 Bonds”) payable to Scott County, Iowa Authority (the “County”), due June 1, 2021; payable \$13,802 monthly, including interest of 4.875%; secured by real property.

The 2003 Bonds in the original amount of \$1,875,000 were issued by the County in October 2003. The County obtained the funds through the issuance and sale of its Health Care Facility Revenue Bonds (Community Health Center, Inc. Project) Series 2003 in the amount of \$1,875,000. The 2003 Bonds were issued to refund the Series 1996A and 1996B Revenue Bonds. The terms of the 2003 Bonds require the Organization to maintain a certain amount in the debt service reserve fund. As of January 31, 2012, the amount held in reserve fund was \$90,228 and is included in assets limited as to use – externally restricted.

- (B) Series 2007 Revenue Bonds (the “2007 Bonds”) payable to The City of Buffalo, Iowa Authority, (the “City”), due April 1, 2017. The 2007 Bonds are due in varying installments. Interest is payable quarterly at 4.5%.

The City issued the 2007 Bonds on behalf of the Organization. The City obtained the funds through the issuance and sale of its Facility Revenue Bonds (Community Health Care, Inc. Project) Series 2007 dated March 29, 2007, in the amount of \$2,000,000. The bond proceeds were for the project costs associated with the acquisition of land, construction and renovation, improving, equipping and furnishing of various facilities used by the Organization. The Organization has granted the City a first mortgage and security interest in the buildings and equipment. The terms of the loan agreement require the Organization to maintain a certain amount in a debt service reserve fund. As of January 31, 2012, the amount held in the reserve fund was \$177,478 and is included in assets limited as to use – externally restricted. The bond agreement requires the Organization to comply with certain covenants including a minimum debt service coverage ratio and tangible net worth. One of these covenants was not met for the year ended January 31, 2012. The lender has formally waived noncompliance with this requirement.

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All capital campaign pledges and contributions received will be applied on a quarterly basis to repayment of principal of the 2007 Bonds, or at the Organization's option, to repayment of other indebtedness from the Organization to the lender. Principal payments are payable upon completion of the project and on the first day of each calendar quarter thereafter. Commencing on April 12, 2012, the remaining outstanding principal balance is payable in equal principal and interest installments on a quarterly basis through the maturity of April 1, 2017.

- (C) Due December 18, 2011; payable \$53,333 annually, secured by certain property. This note does not bear interest. This note was paid in full in December 2011.
- (D) Due January 5, 2014; payable in monthly installments of \$7,244 with one final payment of remaining principal at the due date; the monthly payment includes interest at 6.95%. The note is secured by certain property and equipment.
- (E) Due March 1, 2025; payable in monthly installments of \$7,166, which includes interest at 5.875%. At March 1, 2015, and March 1, 2020, the interest rate will be recalculated. The foregoing monthly payments will be reduced, as applicable, if the actual principal amount of the loan disbursed is less than the amount set forth at the beginning of the promissory note based on the interest recalculation.

At the first recalculation on March 1, 2015, the interest rate will be equal to the greater of (1) the sum of the yield to maturity of United States Treasury obligations, with a maturity equal to the maturity date of the note, plus 1.75% basis points or (2) 5.50%. At the second recalculation on March 1, 2020, the interest rate will be equal to the greater of (1) the sum of the yield to maturity of United States Treasury obligations, with a maturity equal to the maturity date of the note, plus 1.75% basis points or (2) 5.00%. The note is secured by certain real property.

Aggregate annual maturities of long-term debt at January 31, 2012, are:

2013	\$ 472,708
2014	903,012
2015	461,723
2016	484,002
2017	507,368
Thereafter	1,393,010
	\$ 4,221,823

Community Health Care, Inc.
Notes to Financial Statements
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Note 8: Temporarily Restricted Net Assets

Temporarily restricted net assets are available for the following purpose or periods:

	<u>2012</u>	<u>2011</u>
Expanding operations campaign	\$ 34,765	\$ 94,765
Health care services after January 31	<u>100,000</u>	<u>150,000</u>
	<u>\$ 134,765</u>	<u>\$ 244,765</u>

During 2012 and 2011, net assets were released from donor restrictions by incurring expenses, satisfying the restricted purpose of the expanding operations campaign and other health care services in the amount of \$110,000 and \$189,661, respectively.

Note 9: Functional Expenses

The Organization provides health care services primarily to residents within its geographic area. Expenses related to providing these services are as follows:

	<u>2012</u>	<u>2011</u>
Health care services	\$ 16,972,011	\$ 14,572,077
General and administrative	<u>5,695,647</u>	<u>5,243,125</u>
	<u>\$ 22,667,658</u>	<u>\$ 19,815,202</u>

Note 10: Operating Leases

The Organization entered into a noncancelable operating lease for a health care facility expiring in February 2024. Future minimum lease payments at January 31, 2012, were:

2013	\$ 198,770
2014	204,750
2015	210,860
2016	217,230
2017	223,730
Thereafter	<u>1,765,140</u>
Future minimum lease payments	<u>\$ 2,820,480</u>

Community Health Care, Inc.

Notes to Financial Statements

January 31, 2012 and 2011

Note 11: Pension Plan

The Organization has a defined contribution pension plan covering substantially all employees with one or more years of service and greater than 1,000 hours worked per year. The Organization contributes, on behalf of each covered employee, an amount equal to 5% of their compensation. As of January 2010, the plan was amended so that the Organization contributes, on behalf of each covered employee, an amount equal to 2.5% of their compensation, if the covered employee was not already contributing 5%. Total pension expense for the years ended January 31, 2012 and 2011, was \$372,199 and \$316,797, respectively.

Note 12: Construction in Progress

The Organization is in the process of building a new facility in East Moline, Illinois, and in the planning stages of building a new site in Clinton, Iowa. The East Moline facility is expected to be completed in July 2012 at a total cost of approximately \$2,000,000. The Organization is financing the construction with Affordable Care Act federal grant funds (see *Note 2*).

Note 13: Significant Estimates and Concentrations

Accounting principles generally accepted in the United States of America require disclosure of certain significant estimates and current vulnerabilities due to certain concentrations. Those matters include the following:

Grant Revenues

Concentration of revenues related to grant awards and other support is described in *Note 2*.

Allowance for Net Patient Service Revenue Adjustments

Estimates of allowances for adjustments included in net patient service revenue are described in *Notes 1* and *3*.

Malpractice Claims

Estimates related to the accrual for medical malpractice claims are described in *Note 6*.

Community Health Care, Inc.
Notes to Financial Statements
January 31, 2012 and 2011

Self-Insurance

The Organization is self-insured for employee group health care. Liabilities include an accrual for health claims that have been incurred and an estimate of claims incurred but not reported. Claims liabilities are reevaluated periodically to take into consideration recently settled claims, frequency of claims and other economic and social factors.

Litigation

In the normal course of business, the Organization is, from time to time, subject to allegations that may or do result in litigation. Some of these allegations are in areas not covered by the Organization's commercial insurance; for example, allegations regarding employment practices or performance of contracts. The Organization evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of counsel, management records an estimate of the amount of ultimate expected loss, if any, for each of these matters. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

Current Economic Conditions

The current protracted economic decline continues to present community health centers with difficult circumstances and challenges, which in some cases have resulted in potential future declines in contributions, constraints on liquidity and difficulty obtaining financing. The financial statements have been prepared using values and information currently available to the Organization.

Current economic conditions, including the rising unemployment rate, have made it difficult for certain of our patients to pay for services rendered. As employers make adjustments to health insurance plans or more patients become unemployed, services provided to self-pay and other payers may significantly impact net patient service revenue, which could have an adverse impact on the Organization's future operating results. Further, the effect of economic conditions on the states may have an adverse effect on cash flows related to the Medicaid programs.

Given the volatility of current economic conditions, the values of assets and liabilities recorded in the financial statements could change in the future, resulting in material future adjustments in allowances for accounts and contributions receivable that could negatively impact the Organization's ability to maintain sufficient liquidity.

Supplementary Information

Community Health Care, Inc.
Schedule of Expenditures of Federal Awards
Year Ended January 31, 2012

Cluster/Program	Federal Agency/ Pass-Through Entity	CFDA Number	Grant or Identifying Number	Amount Expended
Consolidated Health Centers	U.S. Department of Health and Human Services	93.224	6 H80CS 00670-10-02	\$ 3,076,014
ARRA - Capital Improvement Program	U.S. Department of Health and Human Services	93.703	6 C81CS 13997-01-04	49,998
Grants to Provide Early Intervention Services with Respect to HIV Disease	U.S. Department of Health and Human Services	93.918	6H76HA 00212-14-01	343,290
Maternal and Child Health Services Block Grant to the States	U.S. Department of Health and Human Services/Scott County Health Department	93.994	65093-20 TCHCCH12	33,960
National Center for Research Resources	U.S. Department of Health and Human Services/The University of Iowa	93.389	5 UL1RR 024979-05	67,622
Immunization Grants	U.S. Department of Health and Human Services/ Scott County Health Department	93.268	65093-20 SCHC IS 12	27,409
Affordable Care Act - Capital Development Grants	U.S. Department of Health and Human Services	93.526	6 C8ACS 21319-01-02	<u>3,949,040</u>
				<u><u>\$ 7,547,333</u></u>

Notes to Schedule

1. This schedule includes the federal awards activity of Community Health Care, 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*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.
2. Community Health Care, Inc. did not provide any federal awards to a subrecipient during the year ended January 31, 2012.

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

Board of Directors
Community Health Care, Inc.
Davenport, Iowa

We have audited the financial statements of Community Health Care, Inc. (the "Organization") as of and for the year ended January 31, 2012, and have issued our report thereon dated August 28, 2012. We conducted our audit 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Organization'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 Organization's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Organization's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses and, therefore, there can be no assurance that all deficiencies, significant deficiencies or material weaknesses have been identified. However, as discussed in the accompanying schedule of findings and questioned costs, we identified a certain deficiency in internal control over financial reporting that we consider to be a material weakness.

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 Organization's financial statements will not be prevented or detected and corrected on a timely basis. We consider the deficiency described in the accompanying schedule of findings and questioned costs as item 12-1 to be a material weakness.

Board of Directors
Community Health Care, Inc.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Organization's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance 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*.

The Organization's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the Organization's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the governing body, management and others within the Organization and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

BKD, LLP

August 28, 2012

**Independent Accountants' Report on Compliance with Requirements
That Could Have a Direct and Material Effect on Each Major Program
and on Internal Control Over Compliance in Accordance with
OMB Circular A-133**

Board of Directors
Community Health Care, Inc.
Davenport, Iowa

Compliance

We have audited the compliance of Community Health Care, Inc. (the "Organization") with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that could have a direct and material effect on its major federal program for the year ended January 31, 2012. The Organization's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to its major federal program is the responsibility of the Organization's management. Our responsibility is to express an opinion on the compliance of the Organization based on our audit.

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 Organization'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. Our audit does not provide a legal determination on the Organization's compliance with those requirements.

In our opinion, Community Health Care, Inc. complied, in all material respects, with the requirements referred to above that could have a direct and material effect on its major federal program for the year ended January 31, 2012.

Board of Directors
Community Health Care, Inc.

Internal Control Over Compliance

The management of Community Health Care, Inc. is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Organization's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance 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 Organization'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.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of the governing body, management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

BKD, LLP

August 28, 2012

Community Health Care, Inc.
Schedule of Findings and Questioned Costs
Year Ended January 31, 2012

Summary of Auditor's Results

1. The opinion expressed in the independent accountants' report was:
 Unqualified Qualified Adverse Disclaimed

2. The independent accountants' report on internal control over financial reporting disclosed:
Significant deficiency(ies)? Yes No
Material weakness(es)? Yes No

3. Noncompliance considered material to the financial statements was disclosed by the audit? Yes No

4. The independent accountants' report on internal control over compliance with requirements that could have a direct and material effect on major federal awards programs disclosed:
Significant deficiency(ies)? Yes No
Material weakness(es)? Yes No

5. The opinion expressed in the independent accountants' report on compliance with requirements that could have a direct and material effect on major federal awards was:
 Unqualified Qualified Adverse Disclaimed

6. The audit disclosed findings required to be reported by OMB Circular A-133? Yes No

Community Health Care, Inc.
Schedule of Findings and Questioned Costs
Year Ended January 31, 2012

7. The Organization's major program was:

Cluster/Program	CFDA Number
Affordable Care Act – Capital Development Grants	93.526

8. The threshold used to distinguish between Type A and Type B programs as those terms are defined in OMB Circular A-133 was \$300,000.

9. The Organization qualified as a low-risk auditee as that term is defined in OMB Circular A-133.

Yes

No

Community Health Care, Inc.
Schedule of Findings and Questioned Costs
Year Ended January 31, 2012

Findings Required to be Reported by *Government Auditing Standards*

Reference Number	Finding	Questioned Costs
12-1	<p>Criteria or Specific Requirement – Management is responsible for establishing and maintaining effective internal control over financial reporting.</p> <p>Condition – The financial statements required adjusting journal entries related to the recording of construction in progress and the corresponding recognition of grant revenue related to the funding of that construction. Adjusting journal entries were also needed to remove the previously used building from the property and equipment subsidiary ledger.</p> <p>Context – Management is responsible for maintaining the property and equipment subsidiary ledger to ensure that all construction projects are recorded correctly and that all assets that are no longer in use are removed from the ledger.</p> <p>Effect – Adjusting journal entries were needed for the year-end financial statements to be in accordance with accounting principles generally accepted in the United States of America (GAAP).</p> <p>Cause – The property and equipment subsidiary ledger used to prepare the financial statements was not properly reconciled and necessary adjustments were not made.</p> <p>Recommendation – The property and equipment subsidiary ledger should be reconciled monthly before the preparation of the Organization’s financial statements.</p> <p>Views of Responsible Officials and Planned Corrective Actions – Management has taken steps internally by providing education to staff to help ensure that future construction projects will be recorded in accordance with GAAP.</p>	None

Community Health Care, Inc.
Schedule of Findings and Questioned Costs
Year Ended January 31, 2012

Findings Required to be Reported by OMB Circular A-133

Reference Number	Summary of Finding	Questioned Costs
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No matters are reportable.

Community Health Care, Inc.
Summary Schedule of Prior Audit Findings
Year Ended January 31, 2012

Reference Number	Finding	Status
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No matters are reportable.