

EL RIO SANTA CRUZ NEIGHBORHOOD HEALTH CENTER, INC.
CONSOLIDATED FINANCIAL STATEMENTS, OTHER FINANCIAL
INFORMATION AND SINGLE AUDIT REPORTS

December 31, 2012 and 2011

El Rio Santa Cruz Neighborhood Health Center, Inc.
Consolidated Financial Statements, Other Financial
Information and Single Audit Reports

December 31, 2012 and 2011

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Independent Auditors' Report

The Board of Directors
El Rio Santa Cruz Neighborhood Health Center, Inc.
Tucson, Arizona

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of El Rio Santa Cruz Neighborhood Health Center, Inc. (the Center, a nonprofit organization), which comprise the consolidated statement of financial position as of December 31, 2012 and 2011, and the related consolidated statements of activities, 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 consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America 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 consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of El Rio Santa Cruz Neighborhood Health Center, Inc. as of December 31, 2012 and 2011, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying schedule of expenditures of federal awards, as required by Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated 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 May 7, 2013, 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, 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.



May 7, 2013

El Rio Santa Cruz Neighborhood Health Center, Inc.
Consolidated Statements of Financial Position
December 31,

	2012	2011
Assets		
Current assets:		
Cash and cash equivalents	\$ 19,040,625	\$ 18,831,337
Accounts receivable, net	2,835,891	3,397,129
Prospective Payment System (PPS) receivable, net	4,976,590	5,272,160
Grants and other receivables	575,951	393,733
Other current assets	1,471,848	1,274,474
Total current assets	28,900,905	29,168,833
Investments	6,471,316	126,600
Assets limited as to use	3,698,747	3,679,910
Deferred financing costs	129,792	139,113
Land, buildings and equipment:		
Land	2,728,103	2,738,603
Buildings and improvements	21,683,154	21,125,193
Equipment	17,703,705	16,228,937
	42,114,962	40,092,733
Less accumulated depreciation	22,378,963	20,264,221
	19,735,999	19,828,512
Total assets	\$ 58,936,759	\$ 52,942,968
Liabilities and Net Assets		
Current liabilities:		
Accrued employee compensation	\$ 5,154,478	\$ 4,776,392
Accounts payable and accrued expenses	2,812,133	1,278,492
Contingency and risk pool reserves	2,007,853	2,441,480
Current portion of long-term debt	176,187	222,988
Other current liabilities	346,698	653,031
Total current liabilities	10,497,349	9,372,383
Long-term debt, less current portion	2,820,264	3,024,515
Other noncurrent liabilities	321,700	316,912
Total liabilities	13,639,313	12,713,810
Net assets:		
Unrestricted net assets:		
Undesignated	43,209,681	37,933,735
Board designated	236,931	236,931
	43,446,612	38,170,666
Temporarily restricted	1,826,916	2,034,574
Permanently restricted	23,918	23,918
Total net assets	45,297,446	40,229,158
Total liabilities and net assets	\$ 58,936,759	\$ 52,942,968

The accompanying notes are an integral part of these financial statements.

El Rio Santa Cruz Neighborhood Health Center, Inc.

Consolidated Statements of Activities

Years Ended December 31,

	<u>2012</u>	<u>2011</u>
Revenue and public support:		
Patient service fees	\$ 60,028,543	\$ 58,688,174
Capitation revenue	9,671,750	9,476,872
Public support - Department of Health and Human Services	10,647,432	10,640,584
Public support - Medicaid EHR Incentive Program	2,380,000	
Public support - other	982,152	638,161
Other	4,016,675	3,821,127
In-kind contributions	<u>2,739,020</u>	<u>2,642,825</u>
Total revenue and public support	90,465,572	85,907,743
Expenses:		
Salaries and wages	46,723,231	43,308,311
Employee benefits	10,039,947	9,881,982
Medical services	3,629,748	3,279,885
Supplies	11,225,098	10,701,561
General and administrative	8,367,434	8,240,129
Depreciation	2,394,436	2,414,381
Interest	119,299	185,385
In-kind expenses	<u>2,739,020</u>	<u>2,642,825</u>
Total expenses	<u>85,238,213</u>	<u>80,654,459</u>
Excess of revenue and public support over expenses	5,227,359	5,253,284
Change in fair value of interest rate swap	(4,788)	(284,498)
Capital grant	<u>53,375</u>	
Increase in unrestricted net assets	<u>\$ 5,275,946</u>	<u>\$ 4,968,786</u>

The accompanying notes are an integral part of these financial statements.

El Rio Santa Cruz Neighborhood Health Center, Inc.
Consolidated Statements of Changes in Net Assets
Years Ended December 31,

	2012	2011
Unrestricted net assets:		
Excess of revenue and public support over expenses	\$ 5,227,359	\$ 5,253,284
Change in fair value of interest rate swap	(4,788)	(284,498)
Capital grant	53,375	
Increase in unrestricted net assets	5,275,946	4,968,786
Temporarily restricted net assets:		
Contributions	493,881	989,923
Net assets released from restrictions	(701,539)	(910,512)
(Decrease) increase in temporarily restricted net assets	(207,658)	79,411
Increase in net assets	5,068,288	5,048,197
Net assets, beginning of the year	40,229,158	35,180,961
Net assets, end of the year	\$ 45,297,446	\$ 40,229,158

The accompanying notes are an integral part of these financial statements.

El Rio Santa Cruz Neighborhood Health Center, Inc.

Consolidated Statements of Cash Flows

Years Ended December 31,

	<u>2012</u>	<u>2011</u>
Operating activities		
Increase in net assets	\$ 5,068,288	\$ 5,048,197
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation	2,394,436	2,414,381
Amortization of deferred financing costs	9,321	58,764
Realized and unrealized gain on investments	(297,046)	(24,466)
Change in fair value of interest rate swap	4,788	284,498
Change in operating assets and liabilities:		
Accounts receivable, net	561,238	(1,011,974)
PPS receivable, net	295,570	549,115
Grants and other receivables	(182,218)	178,886
Other current assets	(197,374)	3,382
Accrued employee compensation	378,086	642,738
Accounts payable and accrued expenses	1,533,641	(375,552)
Contingency and risk pool reserves	(433,627)	787,323
Other current liabilities	<u>(306,333)</u>	<u>(58,949)</u>
Net cash provided by operating activities	8,828,770	8,496,343
Investing activities		
Purchases of land, buildings and improvements, and equipment	(2,425,177)	(2,774,853)
Proceeds from sale of equipment	82,874	
Purchases of investments	(8,000,000)	
Proceeds from sales of investments	2,000,000	
Proceeds from maturities of assets limited as to use	245,920	859,060
Purchases of assets limited as to use	<u>(272,047)</u>	<u>(427,202)</u>
Net cash used by investing activities	(8,368,430)	(2,342,995)
Financing activities		
Repayment of bonds and notes payable	<u>(251,052)</u>	<u>(4,300,489)</u>
Net cash used by financing activities	<u>(251,052)</u>	<u>(4,300,489)</u>
Increase in cash and cash equivalents	209,288	1,852,859
Cash and cash equivalents, beginning of year	<u>18,831,337</u>	<u>16,978,478</u>
Cash and cash equivalents, end of year	<u>\$ 19,040,625</u>	<u>\$ 18,831,337</u>
Supplemental Disclosures:		
Cash paid during the year for interest	\$ 119,299	\$ 185,385

The accompanying notes are an integral part of these financial statements.

El Rio Santa Cruz Neighborhood Health Center, Inc.

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

1. Summary of Significant Accounting Policies

Organization

El Rio Santa Cruz Neighborhood Health Center, Inc. (the Center) is a Federally Qualified Health Center (FQHC) that provides health care and related services to the indigent and low-income population of Tucson, Arizona. The Center is an Arizona nonprofit corporation and is exempt from state and federal income taxes as an organization described under Section 501(c)(3) of the Internal Revenue Code.

The Center established the El Rio Foundation, Inc. (the Foundation), whose sole purpose is to solicit, receive gifts, money and property and to distribute the same to the Center to support the charitable, scientific and educational activities related to the Center and its health care mission. The balances and transactions of the Foundation are included in the accompanying financial statements.

Significant inter-company accounts and transactions have been eliminated in these consolidated financial statements.

Use of Estimates

The preparation of the Center's consolidated financial statements in accordance 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 consolidated 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

Cash and cash equivalents include certain investments in highly liquid instruments with initial maturities of three months or less.

Prospective Payment Systems (PPS) Receivable

The PPS receivable represents amounts due for quarterly payments from Arizona Health Care Cost Containment System (AHCCCS), negotiated among AHCCCS and Arizona based Federally Qualified Healthcare Centers FQHCs. The payments are designed to compensate FQHCs for the unreimbursed cost of providing primary health care to AHCCCS members. The payments are made prospectively, based on the number of AHCCCS patients enrolled with the Center. The Center then completes its annual reconciliation between actual costs of providing healthcare services to AHCCCS members and the payments received for those encounters. The PPS receivable balance at December 31, 2012 and 2011 was comprised of the payments due from AHCCCS for the quarters then ended and the annual reconciliation amount due to or from AHCCCS.

Inventory

Inventory is included in other current assets and is comprised of pharmaceutical and medical supplies. Inventory is stated at the lower of cost or market, using the first-in, first-out method. Donated pharmaceuticals are stated at estimated fair value at the date of donation, which approximates cost.

El Rio Santa Cruz Neighborhood Health Center, Inc.

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

1. Summary of Significant Accounting Policies (continued)

Investments

Investments primarily consist of corporate bond funds, equity securities and shares in mutual funds, and are stated at fair value. Unrealized gains and losses are accounted for as other income.

Assets Limited as to Use

Assets limited as to use consist of funds from nonpublic sources set aside by the Center's Board of Directors. The Board retains control of these funds and may, at its discretion, direct the use of these funds in future periods. These investments are carried at fair value based on quoted market prices. Realized and unrealized gains and losses are accounted for as other income.

Land, Buildings and Equipment

Land, buildings and equipment are recorded at historical cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Buildings and improvements are depreciated over 10 to 40 years and equipment is depreciated over 3 to 20 years. Land, buildings, and equipment costing \$1,500 or more are capitalized.

United States Department of Health and Human Services (DHHS) retains a reversionary interest in property and equipment purchased with its funds, as well as proceeds from the sale of such assets.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Center has been limited by donors to a specific time period or purpose. Unconditional pledges to give cash and other assets are reported at fair value at the date the pledge is received. The gifts are reported as temporarily restricted net assets if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and recognized as a component of other revenue. Donor-restricted contributions whose restrictions are met within the same year as received are reflected as unrestricted contributions in other revenue.

Permanently restricted net assets have been restricted by donors to be maintained by the Center in perpetuity.

Patient Service Fees

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 prospectively determined rates, reimbursed costs and discounted charges. Patient service fees are reported at the estimated net realizable amounts from patients, third-party payors, and for other services rendered including retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Annually, Medicare cost reports are filed with the intermediary and are subject to audit and adjustments prior to final settlement. Estimates of final settlement for the 2012 and 2011 cost reports have been considered in the consolidated financial statements.

El Rio Santa Cruz Neighborhood Health Center, Inc.

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

1. Summary of Significant Accounting Policies (continued)

Excess of Revenue and Public Support Over Expenses

The statement of activities includes a measurement for excess of revenues and public support over expenses. Components of changes in net assets excluded from excess of revenues over expenses include capital grants and changes in the fair value of the interest rate swap, consistent with industry practice.

Capitation Revenue

The Center has agreements with various health maintenance organizations (HMOs) and AHCCCS to provide medical services to subscribing participants. Under these agreements, the Center receives monthly capitation payments based on the number of participants, regardless of services actually performed by the Center.

Public Support Revenue

The Center receives annual grants awarded by DHHS which are primarily to subsidize care provided to the indigent population of the community and to provide prevention and primary health care services to persons with HIV infection and/or AIDS. These grants are subject to renewal periodically. The Center also receives grants awarded by the State of Arizona and other entities for specific public health care purposes. The Center recognizes grants as support when eligible costs are incurred or services are provided. Grants receivable are recorded when grant expenses are incurred or contracted services have been provided, but reimbursement has not been received by the Center.

Uncompensated Care

The Center provides health care and other related services to patients who meet certain criteria under its charity care policy. Because the Center does not pursue collection of amounts which qualify as charity care, they are not reported as net patient service fees. Uncompensated care provided by the Center under its policy amounted to \$18,672,097 and \$14,589,384 in 2012 and 2011, respectively.

Derivative and Hedging Instruments

The Center recognizes all derivatives in the statements of financial position at fair value. Derivatives that are not hedges must be adjusted to fair value through the statement of activities. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair values of the derivative are offset against one of the following: the change in fair value of assets, liabilities, or firm commitments through the statement of activities. The ineffective portion of a derivative's change in fair value, if any, is immediately recognized in the excess of revenue over expenses. The Center has an interest rate swap to manage the cost of borrowing its outstanding debt. The interest rate swap converted the interest on the Center's long-term debt from floating rates to fixed rates.

Income Taxes

The Center's federal Forms 990 *Return of Organization Exempt From Income Tax* are generally subject to examination for three years after they were filed, and the related State of Arizona Forms 99 are generally subject to examination for four years from the later of the due date or the file date of the tax return.

El Rio Santa Cruz Neighborhood Health Center, Inc.

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

1. Summary of Significant Accounting Policies (continued)

Expense Allocation

The costs of providing various programs and other activities have been summarized on a functional basis in Note 11. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

In-Kind Contributions

Donated goods or services are recorded at their estimated fair value at the date of the donation, and presented as revenues and expenses in the financial statements.

Reclassifications

Certain reclassifications were made to the 2011 financial statements in order to conform to the 2012 presentation.

Subsequent Events

The Center evaluated all events or transactions that occurred after December 31, 2012 through May 7, 2013, the date the Center issued these financial statements.

2. Concentration of Risk

The Center received payment for services rendered to patients under payment arrangements with payors which include third-party payors contracting with the Center to provide services under capitated arrangements, DHHS and other federally funded programs and others. The following table summarizes the percent of net revenues from each of these payors for the years ended December 31:

	<u>2012</u>	<u>2011</u>
	Percent (%)	Percent (%)
Department of Health and Human Services	12%	13%
Patient service fees:		
PPS revenue (AHCCCS)	28	29
Other patient service revenue	41	42
Capitation revenue	11	12
Other	8	4
	<u>100%</u>	<u>100%</u>

Collective Bargaining Agreement

Certain of the Center's employees, including its physicians and nonmanagerial employees, are covered by a collective bargaining agreement. At December 31, 2012 and 2011, 30 and 26 percent, respectively, of the Center's employees were participating under this agreement.

El Rio Santa Cruz Neighborhood Health Center, Inc.

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

2. Concentration of Risk (continued)

Credit Risk

The Center maintains cash and cash equivalents and investment balances at several financial institutions. Bank and investment accounts at each institution are insured in limited amounts by the Federal Deposit Insurance Corporation (FDIC) and the Securities Investor Protection Corporation (SIPC). Additionally, the Center maintains investments in money market funds that are secured by United States Treasury Securities and are considered to be fully backed by the United States federal government. Balances may at times exceed insured amounts, however, the Center manages the concentration of credit risk by maintaining deposits in multiple, high quality financial institutions. The Center has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk.

3. Accounts Receivable, Net

Accounts receivable consists of charges to patients for services provided to them. Settled patient charges have been adjusted by a sliding fee schedule based on each patient's ability to pay. Allowances for doubtful accounts and contractual allowances have been provided to cover receivable amounts management estimates will not be received.

The following is a summary at December 31:

	<u>2012</u>	<u>2011</u>
Accounts receivable	\$ 5,446,740	\$ 6,170,647
Allowance for doubtful accounts and contractual allowances	<u>2,610,849</u>	<u>2,773,518</u>
Net accounts receivable	2,835,891	3,397,129
PPS receivable, net	<u>4,976,590</u>	<u>5,272,160</u>
	<u>\$ 7,812,481</u>	<u>\$ 8,669,289</u>

4. Investments

Investments were comprised of the following at December 31:

	<u>2012</u>	<u>2011</u>
Fixed income mutual funds	\$ 2,615,849	\$ 24,466
Equity securities and mutual funds	3,723,867	
Other	<u>131,600</u>	<u>126,600</u>
	<u>\$ 6,471,316</u>	<u>\$ 151,066</u>

Investment income included the following for the years ended December 31:

	<u>2012</u>	<u>2011</u>
Unrealized and realized gains	\$ 297,046	
Dividends	56,990	
Interest	<u>159,339</u>	<u>\$ 79,396</u>
	<u>\$ 513,375</u>	<u>\$ 79,396</u>

El Rio Santa Cruz Neighborhood Health Center, Inc.

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

5. Assets Limited as to Use

Assets limited as to use was comprised of the following at December 31:

	<u>2012</u>	<u>2011</u>
Cash equivalents	\$ 3,287,472	\$ 3,309,746
Equity securities	411,275	370,164
	<u>\$ 3,698,747</u>	<u>\$ 3,679,910</u>

6. Long-Term Debt

Long-term debt was comprised of the following at December 31:

	<u>2012</u>	<u>2011</u>
Series 2010 Healthcare Revenue Bonds (Pima County, Arizona)	\$ 2,996,451	\$ 3,208,355
Capital lease obligations, see Note 8		39,148
	<u>2,996,451</u>	<u>3,247,503</u>
Less current portion	176,187	222,988
	<u>\$ 2,820,264</u>	<u>\$ 3,024,515</u>

In June 2010, the Center issued \$4,000,000 Series 2010 Healthcare Revenue Bonds through the Industrial Development Authority of Pima County, Arizona (Series 2010 Bonds). The proceeds of the Series 2010 Bonds were used for construction, acquisition and development of medical facilities and to pay the cost of issuance. Under the terms of the Series 2010 Bonds, one financial institution agreed to purchase all of the bonds. Repayment on the bonds is due in monthly installments of approximately \$21,000 including principal and interest at 3.85 percent according to the terms of an interest rate swap agreement (Note 7). The bonds are secured by a deed of trust on the constructed building and mature in June 2025.

Future principal payments on long-term debt are as follows at December 31, 2012:

2013	\$ 176,187
2014	195,911
2015	203,304
2016	212,305
2017	215,494
Thereafter	1,993,250
Total	<u>\$ 2,996,451</u>

7. Interest Rate Swaps

In June 2010, the Center entered into an interest rate swap agreement that hedges an initial notional amount of \$4,000,000 at a fixed rate of 3.85 percent against 65 percent of 1 month LIBOR plus 1.3 percent. The notional amount will decrease over the term of the agreement as principal payments are made on the underlying debt. The interest rate swap agreement will terminate in June 2025.

Changes in the fair value of the interest rate swap agreements resulted in decreases in net assets of \$4,788 and \$284,498 during the years ended December 31, 2012 and 2011, respectively.

El Rio Santa Cruz Neighborhood Health Center, Inc.

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

8. Leases

The Center entered into capital lease agreements for medical equipment costing \$466,489 during the year ended December 31, 2007, payable in monthly installments of \$10,309, including interest at prime rate plus 1 percent. The interest rate on the leases was 4.25 percent at December 31, 2011. The leases matured in 2012.

Operating Leases

The Center rents certain facilities and telephone, medical and other equipment under noncancelable operating leases. Future minimum rents under these leases are as follows:

Year ending December 31,	
2013	\$ 1,714,379
2014	1,635,886
2015	1,681,173
2016	1,149,918
2017	975,429
Thereafter	<u>1,598,101</u>
Total minimum lease payments	<u>\$ 8,754,886</u>

Rental expense totaled \$2,186,010 and \$2,286,863 in 2012 and 2011, respectively.

9. Retirement Plans

The Center has a 403(b) Tax Deferred Annuity Plan (TDA) for the benefit of its employees, which is administered by a pension plan administrator. The Center contributes 1.5 percent of qualifying gross salaries and wages to the TDA and matches employees' contributions up to three percent of qualifying salaries and wages. The Center made contributions to the TDA of \$1,673,837 and \$1,652,732 in 2012 and 2011, respectively.

10. In-kind Contributions

During the years ended December 31, 2012 and 2011, the Center recognized revenue and expenses of \$2,633,641 and \$2,417,928, respectively, for contributed immunizations and HIV pharmaceuticals received from the State of Arizona. The Center also recognized revenue and expenses of \$82,448 and \$165,055 for pharmaceuticals contributed by drug companies in 2012 and 2011, respectively. In addition, the Center recognized donated services and materials totaling \$22,931 and \$59,842 for fund raising events in 2012 and 2011, respectively. In-kind contributions are measured at estimated fair value at the date of donation.

El Rio Santa Cruz Neighborhood Health Center, Inc.

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

11. Functional Expense Classification

General and administrative expenses exclusively supported primary healthcare activities. The following is a summary of the Center's expenses by function for the years ended December 31:

	<u>2012</u>	<u>2011</u>
Program activities - primary healthcare	\$ 64,496,936	\$ 59,304,957
General and administrative	20,167,853	20,794,480
Fundraising	<u>573,424</u>	<u>555,022</u>
	<u>\$ 85,238,213</u>	<u>\$ 80,654,459</u>

12. Commitments and Contingencies

Healthcare regulation: The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that the Center is in compliance with all applicable laws and regulations. Compliance with such laws and regulations can be subject to future review and interpretation as well as regulatory actions unknown or unasserted at this time.

The Health Insurance Portability and Accountability Act of 1996 (HIPAA) broadened the scope of certain fraud and abuse laws by adding several criminal provisions for fraud offenses that apply to all healthcare benefit programs. HIPAA also added a prohibition against incentives intended to influence decisions by Medicare beneficiaries as to the provider from which they receive services. HIPAA requirements were updated by the Health Information Technology for Economic and Clinical Health Act (HITECH Act). Under the HITECH Act, violations of HIPAA requirements could now result in civil penalties of up to \$50,000 per incident, and up to \$1.5 million in total for each type of violation in a calendar year.

Professional liability insurance: The Federally Supported Health Centers Assistance Act of 1992 authorizes the Public Health Service to assume responsibility for medical malpractice claims involving approved grantees and certain other health care providers under the Federal Tort Claim Act (FTCA). The Center is currently covered under the FTCA. In addition, the Center has general liability and umbrella coverage.

Litigation: Periodically, the Center is involved in litigation and claims arising in the normal course of operations. In the opinion of management, based on consultation with legal counsel, losses, if any, from these matters are covered by insurance or are immaterial.

13. Fair Value Measurements

Accounting principles generally accepted in the United States of America (GAAP) establish a framework for measuring fair value and expand disclosures about fair value measurements, which are determined based on assumptions that market participants would use in pricing assets and liabilities. GAAP establishes a fair value hierarchy that distinguishes between market participant assumptions and the Center's own assumptions about market participant assumptions.

El Rio Santa Cruz Neighborhood Health Center, Inc.

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

13. Fair Value Measurements (continued)

Observable inputs are assumptions based on market data obtained from independent sources; while unobservable inputs are the Center's own assumptions about what market participants would assume based on the best information available in the circumstance.

Level 1 inputs - A quoted price in the active market for an identical asset or liability is considered to be the most reliable evidence of fair value. The Center's assets limited as to use and investments are valued using Level 1 inputs.

Level 2 inputs - These are observable inputs, either directly or indirectly, other than quoted prices included within Level 1. The Center estimates the fair value of its interest rate swap hedge liability described in Note 7 based on level 2 inputs.

Level 3 inputs - These inputs are unobservable and are used to measure fair value only when observable inputs are not available. The Center does not have any financial instruments valued using level 3 inputs.

As of December 2012 and 2011, the fair value of the Center's other financial instruments approximates their carrying amounts, either because the expected collection or payment period is relatively short or because the terms are similar to market terms.

Fair value of assets measured on a recurring basis at December 31, 2012 was as follows:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>
Assets limited as to use	\$ 3,698,747	\$ 3,698,747	
Investments	6,471,316	6,471,316	
Interest rate swap hedge	(321,700)		\$ (321,700)
	<u>\$ 9,848,363</u>	<u>\$ 10,170,063</u>	<u>\$ (321,700)</u>

Fair value of assets measured on a recurring basis at December 31, 2011 was as follows:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>
Assets limited as to use	\$ 3,679,910	\$ 3,679,910	
Investments	126,600	126,600	
Interest rate swap hedge	(316,912)		\$ (316,912)
	<u>\$ 3,489,598</u>	<u>\$ 3,806,510</u>	<u>\$ (316,912)</u>

OTHER FINANCIAL INFORMATION

Certified
Public
Accountants

Tel: (602) 264-3077
Fax: (602) 265-6241

Independent Auditors' Report on Other Financial Information

The Board of Directors
El Rio Santa Cruz Neighborhood Health Center, Inc.
Tucson, Arizona

Our audits were conducted for the purpose of forming an opinion on the 2012 and 2011 consolidated financial statements taken as a whole. The details of the 2012 and 2011 consolidated statements of financial position and the related details of the consolidated statements of activities and changes in net assets of El Rio Santa Cruz Neighborhood Health Center, Inc., and the 2012 statements of financial position and activities and changes in net assets of El Rio Foundation, Inc. (other financial information) are presented for purposes of additional analysis and are not a required part of the basic consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic consolidated financial statements. The other financial information has been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic consolidated 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 other financial information is fairly stated in all material respects in relation to the financial statements as a whole.

Fester & Chapman P.C.

May 7, 2013

El Rio Santa Cruz Neighborhood Health Center, Inc.
 Details of Consolidated Statement of Financial Position
 December 31, 2012

	The Center				Eliminations	Total
	General Fund	Homeless Fund	HIV Early Intervention Fund	Foundation		
Assets						
Current assets:						
Cash and cash equivalents	\$ 16,742,909	\$ 484	\$ 408,301	\$ 1,888,931		\$ 19,040,625
Accounts receivable, net	2,835,891					2,835,891
PPS receivable, net	4,976,590					4,976,590
Grants and other receivables	155,643		362,277	58,031		575,951
Due from other funds	753,861		12,166		\$ (766,027)	
Other current assets	<u>1,469,015</u>			<u>2,833</u>		<u>1,471,848</u>
Total current assets	26,933,909	484	782,744	1,949,795	(766,027)	28,900,905
Investments	6,471,316					6,471,316
Assets limited as to use			3,657	3,695,090		3,698,747
Deferred financing costs	<u>129,792</u>					<u>129,792</u>
	6,601,108		3,657	3,695,090		10,299,855
Land, buildings and equipment:						
Land	2,728,103					2,728,103
Building and improvements	21,683,154					21,683,154
Equipment	<u>17,676,896</u>	<u>2,083</u>	<u>24,726</u>			<u>17,703,705</u>
	42,088,153	2,083	24,726			42,114,962
Less accumulated depreciation	<u>(22,352,154)</u>	<u>(2,083)</u>	<u>(24,726)</u>			<u>(22,378,963)</u>
	19,735,999					19,735,999
Total assets	<u>\$ 53,271,016</u>	<u>\$ 484</u>	<u>\$ 786,401</u>	<u>\$ 5,644,885</u>	<u>\$ (766,027)</u>	<u>\$ 58,936,759</u>
Liabilities and net assets						
Current liabilities:						
Accrued employee compensation	\$ 5,154,478					\$ 5,154,478
Accounts payable and accrued expenses	2,812,133					2,812,133
Contingency and risk pool reserves	2,007,853					2,007,853
Current portion of long-term debt	176,187					176,187
Due to other funds	12,166	\$ 484	\$ 630,143	\$ 123,234	\$ (766,027)	
Other current liabilities	<u>190,440</u>		<u>156,258</u>			<u>346,698</u>
Total current liabilities	10,353,257	484	786,401	123,234	(766,027)	10,497,349
Long-term debt, less current portion	2,820,264					2,820,264
Other noncurrent liabilities	<u>321,700</u>					<u>321,700</u>
Total liabilities	13,495,221	484	786,401	123,234	(766,027)	13,639,313
Net assets:						
Unrestricted	39,775,795			3,670,817		43,446,612
Temporarily restricted				1,826,916		1,826,916
Permanently restricted				<u>23,918</u>		<u>23,918</u>
Total net assets	<u>39,775,795</u>			<u>5,521,651</u>		<u>45,297,446</u>
Total liabilities and net assets	<u>\$ 53,271,016</u>	<u>\$ 484</u>	<u>\$ 786,401</u>	<u>\$ 5,644,885</u>	<u>\$ (766,027)</u>	<u>\$ 58,936,759</u>

See accompanying note.

El Rio Santa Cruz Neighborhood Health Center, Inc.
 Details of Consolidated Statement of Financial Position
 December 31, 2011

	The Center					Eliminations	Total
	General Fund	Homeless Fund	HIV Early Intervention Fund	EXCEL Fund	Foundation		
Assets							
Current assets:							
Cash and cash equivalents	\$ 16,532,667	\$ 27,623	\$ 88,847		\$ 2,182,200		\$ 18,831,337
Accounts receivable, net	3,397,129						3,397,129
PPS receivable, net	5,272,160						5,272,160
Grants and other receivables	73,019		245,069		75,645		393,733
Due from other funds	404,746				5,611	\$ (410,357)	
Other current assets	<u>1,274,474</u>						<u>1,274,474</u>
Total current assets	<u>26,954,195</u>	<u>27,623</u>	<u>333,916</u>		<u>2,263,456</u>	<u>(410,357)</u>	<u>29,168,833</u>
Investments	126,600						126,600
Assets limited as to use			3,657		3,676,253		3,679,910
Deferred financing costs	<u>139,113</u>						<u>139,113</u>
	265,713		3,657		3,676,253		3,945,623
Land, buildings and equipment:							
Land	2,738,603						2,738,603
Building and improvements	21,125,193						21,125,193
Equipment	<u>16,202,128</u>	<u>2,083</u>	<u>24,726</u>				<u>16,228,937</u>
	40,065,924	2,083	24,726				40,092,733
Less accumulated depreciation	<u>(20,237,412)</u>	<u>(2,083)</u>	<u>(24,726)</u>				<u>(20,264,221)</u>
	<u>19,828,512</u>						<u>19,828,512</u>
Total assets	<u>\$ 47,048,420</u>	<u>\$ 27,623</u>	<u>\$ 337,573</u>		<u>\$ 5,939,709</u>	<u>\$ (410,357)</u>	<u>\$ 52,942,968</u>
Liabilities and net assets							
Current liabilities:							
Accrued employee compensation	\$ 4,776,392						\$ 4,776,392
Accounts payable and accrued expenses	1,278,492						1,278,492
Contingency and risk pool reserves	2,441,480						2,441,480
Current portion of long-term debt	222,988						222,988
Due to other funds	5,611	\$ 27,623	\$ 248,095		\$ 129,028	\$ (410,357)	
Other current liabilities	<u>563,553</u>		<u>89,478</u>				<u>653,031</u>
Total current liabilities	<u>9,288,516</u>	<u>27,623</u>	<u>337,573</u>		<u>129,028</u>	<u>(410,357)</u>	<u>9,372,383</u>
Long-term debt, less current portion	3,024,515						3,024,515
Other noncurrent liabilities	<u>316,912</u>						<u>316,912</u>
Total liabilities	<u>12,629,943</u>	<u>27,623</u>	<u>337,573</u>		<u>129,028</u>	<u>(410,357)</u>	<u>12,713,810</u>
Net assets:							
Unrestricted	34,418,477				3,752,189		38,170,666
Temporarily restricted					2,034,574		2,034,574
Permanently restricted					<u>23,918</u>		<u>23,918</u>
Total net assets	<u>34,418,477</u>				<u>5,810,681</u>		<u>40,229,158</u>
Total liabilities and net assets	<u>\$ 47,048,420</u>	<u>\$ 27,623</u>	<u>\$ 337,573</u>		<u>\$ 5,939,709</u>	<u>\$ (410,357)</u>	<u>\$ 52,942,968</u>

See accompanying note.

El Rio Santa Cruz Neighborhood Health Center, Inc.
 Details of Consolidated Statement of Activities and Changes in Net Assets
 December 31, 2012

	The Center			Foundation	Eliminations	Total
	General Fund	Homeless Fund	HIV Early Intervention Fund			
Unrestricted net assets:						
Revenue and public support:						
Patient service fees	\$ 59,699,193	\$ 217,050	\$ 198,261		\$ (85,961)	\$ 60,028,543
Capitation revenue	9,671,750					9,671,750
Public support - Department of Health and Human Services	10,647,432	879,059	1,035,939		(1,914,998)	10,647,432
Public Support - Medicaid EHR Incentive Program	2,380,000					2,380,000
Public support - other	982,152		1,420,693		(1,420,693)	982,152
Other	3,258,336	413,257	314,414	\$ 1,344,154	(1,313,486)	4,016,675
In-kind contributions	<u>2,716,089</u>			<u>22,931</u>		<u>2,739,020</u>
Total operating revenue and public support	89,354,952	1,509,366	2,969,307	1,367,085	(4,735,138)	90,465,572
Expenses:						
Salaries and wages	45,951,283	928,738	1,885,975		(2,042,765)	46,723,231
Employee benefits	9,816,034	180,983	411,248		(368,318)	10,039,947
Medical services	3,591,217	76,132	241,628	38,531	(317,760)	3,629,748
Supplies	11,202,392	81,879	123,738	22,706	(205,617)	11,225,098
General and administrative	8,255,471	241,634	306,718	1,364,289	(1,800,678)	8,367,434
Depreciation	2,394,436					2,394,436
Interest	119,299					119,299
In-kind expenses	<u>2,716,089</u>			<u>22,931</u>		<u>2,739,020</u>
Total expenses	84,046,221	1,509,366	2,969,307	1,448,457	(4,735,138)	85,238,213
Excess (deficiency) of revenue and public support over (under) expenses	5,308,731			(81,372)		5,227,359
Change in fair value of interest rate swap	(4,788)					(4,788)
Capital grant	<u>53,375</u>					<u>53,375</u>
Increase (decrease) in unrestricted net assets	5,357,318			(81,372)		5,275,946
Temporarily restricted net assets:						
Contributions				493,881		493,881
Net assets released from restrictions				<u>(701,539)</u>		<u>(701,539)</u>
Decrease in temporarily restricted net assets				<u>(207,658)</u>		<u>(207,658)</u>
Increase (decrease) in net assets	<u>\$ 5,357,318</u>	<u>\$</u>	<u>\$</u>	<u>\$ (289,030)</u>	<u>\$</u>	<u>\$ 5,068,288</u>

See accompanying note.

El Rio Santa Cruz Neighborhood Health Center, Inc.
Details of Consolidated Statement of Activities and Changes in Net Assets
December 31, 2011

	The Center						Total
	General Fund	Homeless Fund	HIV Early Intervention Fund	EXCEL Fund	Foundation	Eliminations	
Unrestricted net assets:							
Revenue and public support:							
Patient service fees	\$ 58,525,819		\$ 274,855			\$ (112,500)	\$ 58,688,174
Capitation revenue	9,476,872						9,476,872
Public support - Department of Health and Human Services	10,640,584	\$ 864,211	1,035,939	\$ 273,291		(2,173,441)	10,640,584
Public support - other	688,016		1,378,619			(1,428,474)	638,161
Other	4,758,932	387,073	326,285		\$ 1,342,991	(2,994,154)	3,821,127
In-kind contributions	<u>2,582,983</u>				<u>59,842</u>		<u>2,642,825</u>
Total operating revenue and public support	86,673,206	1,251,284	3,015,698	273,291	1,402,833	(6,708,569)	85,907,743
Expenses:							
Salaries and wages	42,923,369	760,626	1,868,390	150,236		(2,394,310)	43,308,311
Employee benefits	9,505,697	154,004	467,465	40,404		(285,588)	9,881,982
Medical services	3,257,233	72,947	273,057	36,493	22,653	(382,498)	3,279,885
Supplies	10,683,738	48,455	74,611	1,741	17,825	(124,809)	10,701,561
General and administrative	8,120,598	215,252	332,175	44,417	3,049,051	(3,521,364)	8,240,129
Depreciation	2,414,381						2,414,381
Interest	185,385						185,385
In-kind expenses	<u>2,582,983</u>				<u>59,842</u>		<u>2,642,825</u>
Total expenses	79,673,384	1,251,284	3,015,698	273,291	3,149,371	(6,708,569)	80,654,459
Excess (deficiency) of revenue and public support over (under) expenses	6,999,822				(1,746,538)		5,253,284
Change in fair value of interest rate swap	<u>(284,498)</u>						<u>(284,498)</u>
Increase (decrease) in unrestricted net assets	6,715,324				(1,746,538)		4,968,786
Temporarily restricted net assets:							
Contributions					989,923		989,923
Net assets released from restrictions					<u>(910,512)</u>		<u>(910,512)</u>
Increase in temporarily restricted net assets					79,411		79,411
Increase (decrease) in net assets	<u>\$ 6,715,324</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$ (1,667,127)</u>	<u>\$</u>	<u>\$ 5,048,197</u>

See accompanying note.

El Rio Santa Cruz Neighborhood Health Center, Inc.

Note to Other Financial Information

December 31, 2012 and 2011

1. Summary of Significant Accounting Policies

Fund Accounting

The following funds are maintained by the Center:

- *General Fund* - represents funds used for program activities allowed by the Department of Health and Human Services (DHHS) under a Section 330 grant and for activities related to the provision of health care and related services to patients.
- *Homeless Fund* - represents funds under a DHHS grant to be used to provide general care for the homeless population.
- *HIV Early Intervention Fund* - represents funds under a DHHS grant to be used in prevention and delivery of primary healthcare services to persons with the HIV infection and/or AIDS.
- *Expanded Care for Enhanced Living (EXCEL) Fund* - represented funds received from the Substance Abuse and Mental Health Services Administration. The funds were used to provide intensive outpatient services to address the mental health needs of HIV patients residing in Pima County and southern Arizona.

El Rio Foundation, Inc.
Statement of Financial Position
December 31, 2012

Assets	
Cash and cash equivalents	\$ 1,888,931
Contributions and other receivables:	
Unrestricted	46,113
Temporarily restricted	11,918
Prepaid expenses	2,833
Assets limited as to use:	
Unrestricted	3,671,172
Permanently restricted	<u>23,918</u>
	<u>3,695,090</u>
Total assets	<u><u>\$ 5,644,885</u></u>
 Liabilities and net assets	
Liabilities:	
Due to the Center	<u>\$ 123,234</u>
Total liabilities	123,234
 Net assets:	
Unrestricted net assets:	
Undesignated	3,433,886
Board designated	<u>236,931</u>
	3,670,817
Temporarily restricted net assets	1,826,916
Permanently restricted net assets	<u>23,918</u>
Total net assets	<u>5,521,651</u>
Total liabilities and net assets	<u><u>\$ 5,644,885</u></u>

El Rio Foundation, Inc.
Statement of Activities and Changes in Net Assets
Year Ended December 31, 2012

	<u>Unrestricted Net Assets</u>	<u>Temporarily Restricted Net Assets</u>	<u>Permanently Restricted Net Assets</u>	<u>Total</u>
Revenues and support:				
Grants and contributions	\$ 149,440	\$ 493,881		\$ 643,321
Special events revenue	410,914			410,914
Net investment income	82,256			82,256
In-kind contributions	<u>22,931</u>			<u>22,931</u>
	665,541	493,881		1,159,422
Net assets released from restrictions	<u>701,539</u>	<u>(701,539)</u>		
Total revenues and support	1,367,080	(207,658)		1,159,422
Expenses:				
Program services	1,272,356			1,272,356
Management and general	12,635			12,635
Special events and fundraising	140,530			140,530
In-kind expenses	<u>22,931</u>			<u>22,931</u>
Total expenses	<u>1,448,452</u>			<u>1,448,452</u>
Decrease in net assets	(81,372)	(207,658)		(289,030)
Net assets, beginning of year	<u>3,752,189</u>	<u>2,034,574</u>	<u>\$ 23,918</u>	<u>5,810,681</u>
Net assets, end of year	<u>\$ 3,670,817</u>	<u>\$ 1,826,916</u>	<u>\$ 23,918</u>	<u>\$ 5,521,651</u>

SINGLE AUDIT SECTION

El Rio Santa Cruz Neighborhood Health Center, Inc.
Schedule of Expenditures of Federal Awards
Year Ended December 31, 2012

<u>Federal Grantor/Program Title/Pass-Through Grantor</u>	<u>Pass-Through Grantor's Number</u>	<u>CFDA Number</u>	<u>Expenditures</u>
U.S. Department of Health and Human Services			
Direct programs:			
<i>Health Centers Cluster:</i>			
Consolidated Health Centers	N/A	93.224	\$ 7,220,563
ARRA - Health Center Integrated Services Development Initiative (Health Information Technology Implementation)	N/A	93.703	<u>555,774</u>
<i>Total Health Centers Cluster</i>			<u>7,776,337</u>
Affordable Care Act (ACA) Grants for Capital Development in Health Centers	N/A	93.526	53,377
Grants to Provide Outpatient Early Intervention Services with Respect to HIV Disease	N/A	93.918	1,035,939
Passed through the Arizona Department of Health Services:			
Centers for Disease Control and Prevention_ Investigations and Technical Assistance (Colorectal Cancer Fit at Fifty Health Check Program)	ADHS12-009812	93.283	150,724
HIV Care Formula Grants (ADAP Medications and TAP)	ADHS11-004697	93.917	<u>1,420,693</u>
Total U.S. Department of Health and Human Services			10,437,070
U.S. Department of Agriculture			
Passed through the Arizona Department of Health Services:			
Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)	ADHS11-001023	10.557	<u>422,004</u>
Total Expenditures of Federal Awards			<u>\$ 10,859,074</u>

The accompanying notes are an integral part of these financial statements.

El Rio Santa Cruz Neighborhood Health Center, Inc.
Notes to Schedule of Expenditures of Federal Awards
Year Ended December 31, 2012

NOTE 1 - Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant transactions of El Rio Santa Cruz Neighborhood Health Center, Inc. (the Center) recorded 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 financial statements.

NOTE 2 - Catalog of Federal Domestic Assistance (CFDA) Numbers

The program titles and CFDA numbers were obtained from the federal or pass-through grantors or the 2012 *Catalog of Federal Domestic Assistance*.

NOTE 3 - Subrecipients

The Center did not pass on any federal funds to subrecipients during the year ended December 31, 2012.

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

The Board of Directors
El Rio Santa Cruz Neighborhood Health Center, Inc.
Tucson, Arizona

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 consolidated financial statements of El Rio Santa Cruz Neighborhood Health Center, Inc. (the Center) as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the Center's basic financial statements, and have issued our report thereon dated May 7, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Center's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Center's internal control. Accordingly, we do not express an opinion on the effectiveness of the Center's internal control.

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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Center's financial statements are free from 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*.

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.

A handwritten signature in cursive script that reads "Fester & Chapman P.C.".

May 7, 2013

Independent Auditors' Report on Compliance For Each Major Federal Program;
Independent Auditors' Report on Internal Control Over Compliance

The Board of Directors
El Rio Santa Cruz Neighborhood Health Center, Inc.
Tucson, Arizona

Report of Compliance for Each Major Federal Program

We have audited El Rio Santa Cruz Neighborhood Health Center, Inc. (the Center)'s compliance with the types of compliance requirements described in the *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 December 31, 2012. 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 each of its major federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for each of 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.

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 December 31, 2012.

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 types of 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 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 was not designed to 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 the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.



May 7, 2013

El Rio Santa Cruz Neighborhood Health Center, Inc.
 Schedule of Findings and Questioned Costs
 Year Ended December 31, 2012

Section I - Summary of Auditors' Results

Financial Statements:

Type of auditors' report issued:	<u>Unqualified</u>		
Internal control over financial reporting:			
Material weakness identified?	_____	yes	_____ <u>X</u> no
Significant deficiencies identified?	_____	yes	_____ <u>X</u> none reported
Noncompliance material to financial statements noted?	_____	yes	_____ <u>X</u> no

Federal Awards:

Internal control over major programs:			
Material weakness identified?	_____	yes	_____ <u>X</u> no
Significant deficiencies identified?	_____	yes	_____ <u>X</u> none reported

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

Any audit findings disclosed that are required to be reported in accordance with Circular A-133 (section .510[a])?	_____	yes	_____ <u>X</u> no
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Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Programs or Cluster</u>
	<i>Health Centers Cluster:</i>
93.224	Consolidated Health Centers
93.703	ARRA - Health Center Integrated Services Development Initiative (Health Information Technology Implementation)
93.917	HIV Care Formula Grants
93.918	Grants to Provide Outpatient Early Intervention Services with Respect to HIV Disease

Dollar threshold used to distinguish between Type A and Type B programs:	<u>\$325,772</u>		
Auditee qualified as low-risk auditee?	_____ <u>X</u>	yes	_____ no

Other Matters: Auditee's Summary Schedule of Prior Audit Findings required to be reported in accordance with Circular A-133 (Section .315[b])?	_____	yes	_____ <u>X</u> no
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Section II - Financial Statement Findings

None noted

Section III - Federal Award Findings and Questioned Costs

None noted