

Esperanza Health Center, Inc.

Financial and Compliance Report

June 30, 2012

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Independent Auditor's Report

To the Board of Directors
Esperanza Health Center, Inc.
Philadelphia, Pennsylvania

We have audited the accompanying balance sheets of Esperanza Health Center, Inc. (the Center) as of June 30, 2012 and 2011, and the related statements of operations and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Center'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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Center's internal control over financial reporting. Accordingly, we express no such opinion. 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 opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Center as of June 30, 2012 and 2011, and 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 reports dated March 20, 2013 and October 25, 2011 on our consideration of the Center's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of those reports 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. Those reports are 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 for the year ended June 30, 2012 is presented for purposes of additional analysis as required by the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits 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 taken as a whole.

McGladrey LLP

Baltimore, Maryland
March 20, 2013

Esperanza Health Center, Inc.

Balance Sheets
June 30, 2012 and 2011

	2012	2011
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 3,137,113	\$ 1,906,358
Patient services receivable, net	1,153,253	1,711,872
Grants receivable	60,206	531,259
Contracts receivable	56,798	79,679
Prepaid expenses and other current assets	<u>77,077</u>	<u>48,526</u>
Total current assets	<u>4,484,447</u>	<u>4,277,694</u>
Property and Equipment:		
Land	280,000	280,000
Furniture and equipment	843,000	373,907
Leasehold improvements	685,397	650,842
Building and improvements	6,539,815	368,350
Construction-in-progress	<u>-</u>	<u>2,210,266</u>
	8,348,212	3,883,365
Less accumulated depreciation and amortization	<u>667,512</u>	<u>393,432</u>
Net property and equipment	<u>7,680,700</u>	<u>3,489,933</u>
Security Deposits	<u>37,815</u>	<u>67,132</u>
Total assets	<u>\$ 12,202,962</u>	<u>\$ 7,834,759</u>
LIABILITIES AND NET ASSETS		
Current Liabilities:		
Accounts payable and accrued expenses	\$ 355,811	\$ 801,902
Accrued compensation	473,967	355,668
Retainage payable	<u>-</u>	<u>156,815</u>
Total current liabilities	829,778	1,314,385
Deferred Rent Liability	<u>117,268</u>	<u>112,346</u>
Total liabilities	<u>947,046</u>	<u>1,426,731</u>
Commitments and Contingencies		
Net Assets:		
Unrestricted:		
Undesignated	9,926,440	5,624,501
Board designated reserve	<u>1,176,564</u>	<u>619,686</u>
	11,103,004	6,244,187
Temporarily restricted	<u>152,912</u>	<u>163,841</u>
Total net assets	<u>11,255,916</u>	<u>6,408,028</u>
Total liabilities and net assets	<u>\$ 12,202,962</u>	<u>\$ 7,834,759</u>

See Notes to Financial Statements.

Esperanza Health Center, Inc.

Statements of Operations and Changes in Net Assets
Years Ended June 30, 2012 and 2011

	2012	2011
Unrestricted Revenue and Support:		
Revenue:		
Patient services, net	\$ 9,118,692	\$ 7,395,970
Other	<u>76,368</u>	<u>69,916</u>
	<u>9,195,060</u>	<u>7,465,886</u>
Support:		
DHHS grants	1,432,724	1,407,701
Contract services and other grants	513,296	532,314
Contributions	186,182	285,431
Donated services	<u>104,406</u>	<u>151,494</u>
	<u>2,236,608</u>	<u>2,376,940</u>
Total unrestricted revenue and support	<u>11,431,668</u>	<u>9,842,826</u>
Expenses:		
Salaries and wages	5,156,212	3,911,713
Employee benefits	1,677,486	1,155,712
Pharmaceuticals	1,429,620	1,295,201
Consultant and contractual services	1,359,644	1,235,049
Occupancy	333,620	306,843
Depreciation and amortization	274,268	145,630
Consumable supplies	379,923	144,253
Equipment rental, repairs and maintenance	150,879	115,351
Professional fees	82,294	74,554
Travel, conferences and meetings	92,400	62,413
Laboratory	86,546	55,551
Telephone	71,798	37,676
Other	76,656	45,012
Dues and subscriptions	23,328	29,923
Printing, postage and publications	23,464	19,889
Insurance	36,849	17,856
Interest	-	12,313
Provision for bad debts	<u>56,437</u>	<u>16,034</u>
Total expenses	<u>11,311,424</u>	<u>8,680,973</u>
Excess of revenue and support over expenses	<u>120,244</u>	<u>1,161,853</u>

(continued)

Esperanza Health Center, Inc.

Statements of Operations and Changes in Net Assets (Continued)
 Years Ended June 30, 2012 and 2011

	2012	2011
Unrestricted Net Assets:		
Excess of revenue and support over expenses	\$ 120,244	\$ 1,161,853
DHHS grants for capital expenditures	4,515,444	1,828,853
Other nonoperating expenses	-	(102,375)
Net assets released from restriction	<u>223,129</u>	<u>-</u>
Increase in unrestricted net assets	<u>4,858,817</u>	<u>2,888,331</u>
Temporarily Restricted Net Assets:		
Contributions for capital expenditures	-	100,000
Contributions for program services	212,200	63,841
Net assets released from restriction	<u>(223,129)</u>	<u>-</u>
(Decrease) increase in temporarily restricted net assets	<u>(10,929)</u>	<u>163,841</u>
Increase in net assets	<u>4,847,888</u>	<u>3,052,172</u>
Net Assets:		
Beginning	<u>6,408,028</u>	<u>3,355,856</u>
Ending	<u>\$ 11,255,916</u>	<u>\$ 6,408,028</u>

Esperanza Health Center, Inc.

Statements of Cash Flows
Years Ended June 30, 2012 and 2011

	2012	2011
Cash Flows From Operating Activities:		
Increase in net assets	\$ 4,847,888	\$ 3,052,172
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	274,268	145,630
Grants and contributions for capital expenditures	(4,515,444)	(1,928,853)
Provision for bad debts	56,437	16,034
Changes in operating assets and liabilities:		
Decrease (increase) in grants receivable	471,053	(468,190)
Decrease (increase) in patient services receivable	502,182	(726,192)
Decrease (increase) in contracts receivable	22,881	(1,190)
(Increase) decrease in prepaid expenses and other current assets	(28,551)	8,769
Decrease in accounts payable and accrued expenses	(446,091)	(22,318)
Decrease in retainage payable	(156,815)	-
Increase in accrued compensation	118,299	44,023
Increase in deferred rent liability	4,922	112,346
Net cash provided by operating activities	1,151,029	232,231
Cash Flows From Investing Activities:		
Purchases of property and equipment	(4,465,035)	(1,372,901)
Increase (decrease) in security deposits	29,317	(8,510)
Net cash used in investing activities	(4,435,718)	(1,381,411)
Cash Flows From Financing Activities:		
Cash received from DHHS grants for capital expenditures	4,515,444	1,828,853
Cash received from contributions for capital expenditures	-	100,000
Principal payments on long-term debt	-	(281,122)
Net cash provided by financing activities	4,515,444	1,647,731
Net increase in cash and cash equivalents	1,230,755	498,551
Cash and Cash Equivalents:		
Beginning	1,906,358	1,407,807
Ending	\$ 3,137,113	\$ 1,906,358
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the year for interest	\$ -	\$ 12,313
Supplemental Schedule of Noncash Operating and Investing Activities:		
Capital acquisitions funded through accounts payable	\$ 8,711	\$ 468,135
Retainage payable	\$ -	\$ 156,815

See Notes to Financial Statements.

Esperanza Health Center, Inc.

Notes to Financial Statements

Note 1. Organization

Esperanza Health Center, Inc. (the Center) operates two healthcare centers located in North Philadelphia, Pennsylvania. The Center provides high-quality and culturally sensitive healthcare, health education and counseling services from a Christian perspective to the Latino community.

The U.S. Department of Health and Human Services (the DHHS) provides substantial support to the Center. The Center is obligated under the terms of the DHHS grants to comply with specified conditions and program requirements set forth by the grantor.

Note 2. Significant Accounting Policies

Basis of Presentation: The Center classifies its net assets into three categories, which are unrestricted, temporarily restricted and permanently restricted.

Unrestricted net assets are reflective of revenues and expenses associated with the principal operating activities of the Center and are not subject to donor-imposed stipulations.

Temporarily restricted net assets are subject to donor-imposed stipulations that may or will be met either by actions of the Center and/or the passage of time. When a donor restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and are reported in the statements of operations and changes in net assets as net assets released from restriction. Temporarily restricted net assets were \$152,912 and \$163,841 at June 30, 2012 and 2011, respectively.

Permanently restricted net assets are subject to donor-imposed stipulations that must be maintained permanently by the Center. There were no permanently restricted net assets at June 30, 2012 and 2011.

Results of Operations: The statements of operations and changes in net assets include excess of revenue and support over expenses that represents the results of operations. Changes in unrestricted net assets which are excluded from excess of revenue and support over expenses, consistent with industry practice, include contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purpose of acquiring such assets).

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. Estimates also affect the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. The use of estimates and assumptions in the preparation of the accompanying financial statements is primarily related to the determination of net patient services receivable.

Cash and Cash Equivalents: The Center maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Center has not experienced any losses in such accounts. All highly liquid investments with maturities of three months or less when purchased are considered to be cash equivalents.

Patient Services Receivable: The collection of receivables from third-party payors and patients is the Center's primary source of cash for operations and is critical to its operating performance. The primary collection risks relate to uninsured patient accounts and patient accounts for which the primary insurance payor has paid, but patient responsibility amounts (deductibles and copayments) remain outstanding.

Patient services receivable from third-party payors are carried at a net amount determined by the original charge for the service provided, less an estimate made for contractual adjustments or discounts provided to third-party payors.

Esperanza Health Center, Inc.

Notes to Financial Statements

Note 2. Significant Accounting Policies (Continued)

Receivables due directly from patients are carried at the original charge for the service provided, less discounts provided under the Center's charity care policy, less amounts covered by third-party payors and less an estimated allowance for doubtful receivables. Management determines the allowance for doubtful accounts by identifying troubled accounts and by historical experience applied to an aging of accounts. The Center considers accounts past due when they are outstanding beyond 60 days with no payment. The Center generally does not charge interest on past due accounts. Patient services receivable are written off as bad debt expense when deemed uncollectible. Recoveries of receivables previously written off are recorded as a reduction of bad debt expense when received. The allowance for doubtful accounts was \$962,599 and \$898,142 at June 30, 2012 and 2011, respectively.

Grants Receivable: Grants receivable consist of costs under the grant agreements which were incurred prior to year-end for which payment has not been received.

Contracts Receivable: Contracts receivable reflect amounts earned but not yet collected for which the Center expects to realize collection of payment.

Property and Equipment: Property and equipment are recorded at cost or, if donated, at the fair value at the date of donation. Depreciation and amortization are recorded on a straight-line basis over the estimated useful lives of the assets, which range from 5 to 40 years. Leasehold improvements are amortized on a straight-line basis over the estimated useful life of the improvement or the term of the lease, whichever is less. The Center capitalizes all purchases of property and equipment in excess of \$5,000.

According to federal regulations, any property and equipment items obtained through federal funds are subject to a lien by the federal government. As long as the Center maintains its tax-exempt status, or so long as the equipment is used for its intended purpose, the Center is not required to reimburse the federal government. If the stated requirements are not met, the Center would be obligated to the federal government in an amount equal to the fair value of the property and equipment.

Deferred Rent: Rents on operating leases are reported whereby total rent expense under the leases is charged to operations on the straight-line basis over the term of the related leases. Deferred rent was \$117,268 and \$112,346 at June 30, 2012 and 2011, respectively. The adjustment to record deferred rent is included in occupancy expenses and other nonoperating expenses.

Patient Services Revenue: Patient services revenue is reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered, including retroactive adjustments under reimbursement agreements with third-party payors, which are subject to audit by administering agencies. These adjustments are accrued on an estimated basis and are adjusted in future periods as final settlements are determined. 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 predetermined fee schedules and discounted charges. The Center provides care to certain patients under Medicaid and Medicare payment arrangements. Self-pay revenue is recorded at published charges with charitable allowances based on a sliding-fee scale deducted to arrive at net self-pay revenue.

Grant Revenue: Grants are recognized as revenue when earned. Expense reimbursement-based grants are recognized as revenue when the qualifying expenses have been incurred and all other grant requirements have been met. Grant funds received prior to the incurrence of the qualifying expenses are deferred.

At June 30, 2012, the Center has received grants from governmental entities that have not been recorded in these financial statements as they have not been earned. These grants require the Center to provide certain healthcare services during specified periods. If such services are not provided, the governmental entities are not obligated to expend the funds allotted under the grants. Grants awarded for the acquisition of long-lived assets are reported as unrestricted nonoperating support during the fiscal year in which the assets are acquired.

Esperanza Health Center, Inc.

Notes to Financial Statements

Note 2. Significant Accounting Policies (Continued)

Contract Revenue: Contract revenue is recognized as revenue when earned. Expense-driven contracts are recognized as revenue when the qualifying expenses have been incurred and all other contract requirements have been met, including the execution of the contract.

Contributions: Contributions are recorded at fair value when received or pledged. Amounts are recorded as temporarily or permanently restricted revenue if they have donor stipulations that limit the use of the donated assets. Bequests are recognized when the probate court declares the will valid. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted assets are reclassified to unrestricted net assets and reported in the statements of operations and changes in net assets as net assets released from restriction.

Donated Services: Contributions of donated services are reported as revenue and expenses at fair value if such services create or enhance nonfinancial assets, or require special skills and are provided by individuals possessing such special skills and would typically need to be purchased by the Center if they had not been donated. The fair value of donated services is based on the differential between the compensation received by the Center's providers and the minimum compensation that is paid to similar providers in this region as indicated from independent sources.

Tax Status: The Center was incorporated as a not-for-profit corporation under the laws of the Commonwealth of Pennsylvania and is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code. Therefore, there is no provision for income taxes. In addition, the Center is not classified as a private foundation.

The Center follows the accounting standard on accounting for uncertainty in income taxes, which addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under this guidance, the Center may recognize the tax benefit from an uncertain tax position only if it is "more likely than not" that the tax position will be sustained on examination by taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The guidance on accounting for uncertainty in income taxes also addresses derecognition, classification, interest and penalties on income taxes, and accounting in interim periods.

Management evaluated the Center's tax positions and concluded that the Center had taken no uncertain tax positions that require adjustment to the financial statements to comply with the provisions of this guidance. Generally, the Center is no longer subject to income tax examinations by U.S. federal, state or local tax authorities for years before 2009, which is the standard statute of limitations look-back period.

Subsequent Events: The Center evaluates events occurring after the date of the financial statements to consider whether or not the impact of such events needs to be reflected and/or disclosed in the financial statements. Such evaluation is performed through the date the financial statements are available to be issued, which was March 20, 2013 for these financial statements.

Note 3. Net Patient Services Revenue

The Center has agreements with third-party payors which provide for reimbursement to the Center at amounts different from its established rates. Contractual adjustments under third-party reimbursement programs represent the difference between the Center's billings at list price and the amounts reimbursed by Medicare, Medicaid and certain other third-party payors and any differences between estimated third-party reimbursement settlements for prior years and subsequent final settlements. A summary of the basis of reimbursement with major third-party payors follows:

Esperanza Health Center, Inc.

Notes to Financial Statements

Note 3. Net Patient Services Revenue (Continued)

Medicare: The Center is paid for patient care services rendered to Medicare program beneficiaries primarily under contractual agreements with third-party Medicare Advantage plans. Additional wraparound reimbursement by a fiscal intermediary is paid on a per encounter basis, according to a cost-based reimbursement system, with a cap for health centers in urban communities. For the years ended June 30, 2012 and 2011, Medicare represented approximately 7% and 6% of net patient services revenue from services provided.

Medicaid: The Center is paid for patient services rendered to Medicaid program beneficiaries primarily under contractual agreements with third-party Medicaid managed care organizations. Additional wraparound reimbursement by the Pennsylvania Department of Public Welfare is generally paid quarterly on a per encounter basis, according to a cost-based reimbursement system. For the years ended June 30, 2012 and 2011, Medicaid represented approximately 54% and 53%, respectively, of net patient services revenue from services provided.

Other Third Party: The Center has also entered into reimbursement agreements with certain non-Medicaid commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment under these agreements includes discounts from established charges and prospectively determined per diem rates. For the years ended June 30, 2012 and 2011, other third-party insured represented approximately 4% and 2%, respectively, of net patient services revenue from services provided.

Medication Dispensary: The Center operates a 340b drug pricing program through a contractual agreement with an independent pharmacy. The service is available only to the Center's patients and can be obtained both through on-site pick up and via mail order. These medications are paid for under contractual relationships with the patient's insurance plan or at a greatly discounted rate for uninsured patients. This discount is not included in the charity care amounts in Note 4. For the years ended June 30, 2012 and 2011, medication dispensary represented approximately 33% and 35%, respectively, of net patient services revenue from services provided.

Laws and regulations governing Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The Center believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs.

Note 4. Charity Care and Social Accountability

The Center is a Federally Qualified Health Center (FQHC), which is a type of provider defined by Section 330 of the Public Health Services Act. The Center provides care to patients utilizing a sliding-fee scale with discounts based on patient family size and income in accordance with federal poverty guidelines. The Center is open to all, regardless of their ability to pay. The amount not recovered under the sliding-fee scale is not reported as revenue as it is not expected to be paid. The Center maintains records to identify and monitor the level of charity care it provides. The amount of charity care provided during the years ended June 30, 2012 and 2011 was \$886,841 and \$682,455, respectively.

Esperanza Health Center, Inc.**Notes to Financial Statements**

Note 5. Concentration of Credit Risk

The mix of gross receivables from patient services and third-party payors is as follows:

	Gross Receivables	
	<u>2012</u>	<u>2011</u>
Medicaid	71 %	80 %
Medicare	14	7
Other third-party payors	2	1
Self-pay	2	2
Medication dispensary	<u>11</u>	<u>10</u>
	<u><u>100 %</u></u>	<u><u>100 %</u></u>

Note 6. Line of Credit

The Center has a revolving line of credit of \$500,000 from a financial institution which matures on April 29, 2013. The line of credit is secured by all assets of the Center. This agreement requires interest to be charged on the outstanding balance at the prime rate plus seventy-five basis points (prime rate at June 30, 2012 was 3.25%). At June 30, 2012 and 2011, there was no outstanding balance on the line of credit.

Note 7. Contract Services and Other Grants

Contract services and other grants revenue consists of the following for the years ended June 30:

	<u>2012</u>	<u>2011</u>
Pennsylvania Department of Health:		
Immunization Grant	\$ 315,345	\$ 298,489
Community Primary Care Challenge Grant	96,590	100,000
Health Federation of Philadelphia:		
HIV Emergency Relief Project Grants	80,755	79,683
Other funders	<u>20,606</u>	<u>54,142</u>
	<u><u>\$ 513,296</u></u>	<u><u>\$ 532,314</u></u>

Note 8. Functional Expenses

Expenses were incurred and allocated as follows for the years ended June 30:

	<u>2012</u>	<u>2011</u>
Program services	\$ 9,001,197	\$ 7,058,100
General and administrative	2,242,322	1,563,691
Fund-raising	<u>67,905</u>	<u>59,182</u>
	<u><u>\$ 11,311,424</u></u>	<u><u>\$ 8,680,973</u></u>

Esperanza Health Center, Inc.**Notes to Financial Statements**

Note 9. Temporarily Restricted Net Assets

Temporarily restricted net assets held by the Center, and changes thereto, are summarized below, and are available for the following purposes as of June 30, 2012:

	<u>Beginning Balance</u>	<u>Net Asset Additions</u>	<u>Net Assets Released</u>	<u>Ending Balance</u>
Capital projects	\$ 100,000	\$ -	\$ (100,000)	\$ -
Specific purpose	<u>63,841</u>	<u>212,200</u>	<u>(123,129)</u>	<u>152,912</u>
	<u>\$ 163,841</u>	<u>\$ 212,200</u>	<u>\$ (223,129)</u>	<u>\$ 152,912</u>

Temporarily restricted net assets held by the Center, and changes thereto, are summarized below, and are available for the following purposes as of June 30, 2011:

	<u>Beginning Balance</u>	<u>Net Asset Additions</u>	<u>Net Assets Released</u>	<u>Ending Balance</u>
Capital projects	\$ -	\$ 100,000	\$ -	\$ 100,000
Specific purpose	<u>-</u>	<u>63,841</u>	<u>-</u>	<u>63,841</u>
	<u>\$ -</u>	<u>\$ 163,841</u>	<u>\$ -</u>	<u>\$ 163,841</u>

Note 10. Pension Plan

The Center has a defined contribution pension plan (the Plan) covering all employees who meet certain eligibility requirements. The amount contributed to the Plan consists of a percentage of participants' compensation and a matching contribution, where applicable. Contributions to the Plan amounted to \$186,292 and \$173,744 for the years ended June 30, 2012 and 2011, respectively.

Note 11. Operating Leases

The Center leases space under a ten-year noncancelable operating lease at 3156 Kensington Avenue, Philadelphia, Pennsylvania. Minimum future lease payments under the noncancelable operating lease are as follows:

<u>Year ending June 30,</u>	
2013	\$ 228,502
2014	233,552
2015	238,602
2016	243,652
2017	248,702
Thereafter	<u>620,275</u>
	<u>\$ 1,813,285</u>

Aggregate space costs for the years ended June 30, 2012 and 2011 amounted to \$260,553 and \$362,475, respectively, including utilities and other common charges.

Esperanza Health Center, Inc.

Notes to Financial Statements

Note 12. Commitments and Contingencies

Contracted Services: The Center has contracted with other agencies to perform certain healthcare services and receives Medicaid and Medicare revenue from the Commonwealth of Pennsylvania and the federal government. Reimbursements received under these contracts and payments under Medicaid and Medicare are subject to audit by federal and other governments and agencies. Upon audit, if discrepancies are discovered, the Center could be held responsible for refunding the amounts in question.

Malpractice Risk: The Center is deemed an employee of the federal government for purposes of malpractice protection and is thus covered under the Federal Tort Claims Act (the FTCA). The FTCA provides malpractice coverage to eligible Public Health Service-supported programs and applies to the Center and its employees while providing services within the scope of employment included under grant-related activities. The Attorney General, through the U.S. Department of Justice, has the responsibility for the defense of the individual and/or grantee for malpractice cases approved for FTCA coverage.

Regulatory Investigation: The U.S. Department of Justice, other federal agencies and the Pennsylvania Department of Public Welfare routinely conduct regulatory investigations and compliance audits of healthcare providers. The Center is subject to these regulatory efforts. Management is currently unaware of any regulatory matters which may have a negative material effect on the Center's financial position or results of operations.

Note 13. Pending Adoption of New Accounting Standards

In July 2012, the FASB released accounting guidance that requires certain health care entities to change the presentation of their statement of activities by reclassifying the provision for bad debts associated with patient services revenue from an operating expense to a deduction from patient services revenue (net of contractual allowances and discounts). Additionally, those healthcare entities are required to provide enhanced disclosure about their policies for recognizing revenue and assessing bad debts. The amendments also require disclosures of patient services revenue (net of contractual allowances and discounts) as well as qualitative and quantitative information about changes in the allowance for doubtful accounts. The guidance is effective for the first annual period ending after December 15, 2012. The Center would be required to adopt this guidance in fiscal year 2013.

Esperanza Health Center, Inc.

Supplementary Information

Schedule of Expenditures of Federal Awards

Year Ended June 30, 2012

See Auditor's Report

Federal Grantor/ Pass-Through Grantor/ Program Title	Federal CFDA Number	Pass-Through Grantor's Number	Federal Expenditures
U.S. Department of Health and Human Services:			
Direct programs:			
Consolidated Health Centers	93.224/93.527	N/A	\$ 768,562
ARRA - Grants to Health Center Programs	93.703	N/A	4,515,444
Grants to Provide Outpatient Early Intervention Services with Respect to HIV Disease	93.918	N/A	664,162
Passed through Health Federation of Philadelphia:			
HIV Emergency Relief Project Grants	93.914	05-21037	<u>80,755</u>
Total expenditures of federal awards			<u><u>\$ 6,028,923</u></u>

Note 1. Basis of Presentation

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Center 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.

Note 2. Subrecipients

The Center provided no federal awards to subrecipients for the year ended June 30, 2012.

Note 3. Affordable Care Act (ACA)

Expenditures reported on the schedule related to Consolidated Health Centers include expenditures of Affordable Care Act (ACA) Grants for New Expanded Services under the Health Center Program (CFDA #93.527).



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

To the Board of Directors
Esperanza Health Center, Inc.
Philadelphia, Pennsylvania

We have audited the financial statements of Esperanza Health Center, Inc. (the Center) as of and for the year ended June 30, 2012, and have issued our report thereon dated March 20, 2013. 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

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

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over financial reporting 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 financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined previously. However, we identified a certain deficiency in internal control over financial reporting, described in the accompanying schedule of findings and questioned costs that we consider to be a significant deficiency in internal control over financial reporting as item IC 12-01. 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.

The Center's response to the finding identified in our audit is described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the Center's response and, accordingly, we express no opinion on it.

Compliance and Other Matters

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

This report is intended solely for the information and use of management, the board of directors, others within the entity, 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.

McGladrey LLP

Baltimore, Maryland
March 20, 2013



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

To the Board of Directors
Esperanza Health Center, Inc.
Philadelphia, Pennsylvania

Compliance

We have audited the compliance of Esperanza Health Center, Inc. (the Center) 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 June 30, 2012. The Center's major federal programs are 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 each of its major federal programs is the responsibility of the Center's management. Our responsibility is to express an opinion on the Center's compliance 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 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. Our audit does not provide a legal determination of the Center's compliance with those requirements.

As described in item CF 12-01 in the accompanying *Schedule of Findings and Questioned Costs*, the Center did not comply with requirements regarding Allowable Cost and Applied Credits that are applicable to its Consolidated Health Center Program. Compliance with such requirements is necessary, in our opinion, for the Center to comply with requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, the Center complied, in all material respects, with the requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2012.

Internal Control Over Compliance

Management of the Center 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 Center's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance 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.

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. However, we identified a certain deficiency in internal control over compliance that we consider to be a significant deficiency as described in the accompanying schedule of findings and questioned costs as item CF 12-01. A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

The Center's response to the finding identified in our audit is described in the accompanying *Schedule of Findings and Questioned Costs*. We did not the Center's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, the board of directors, others within the entity, 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.

The image shows a handwritten signature in cursive script that reads "McGladrey LLP". The signature is written in black ink and is positioned above the typed name and date.

Baltimore, Maryland
March 20, 2013

Esperanza Health Center, Inc.

**Schedule of Findings and Questioned Costs
Year Ended June 30, 2012**

Section I - Summary of Auditor's Results

Financial Statements

Type of auditor's report issued: Unqualified

Internal control over financial reporting:

- Material weakness(es) identified? yes no
- Significant deficiency(ies) identified? yes no

Noncompliance material to financial statements noted? yes no

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? yes no
- Significant deficiency(ies) identified? yes no

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

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

Identification of major programs:

CFDA Number(s)

Name of Federal Program or Cluster

93.224/93.527

U.S. Department of Health and Human Services:
Consolidated Health Centers/Affordable Care Act
(ACA) Grants for New and Expanded Services
under the Health Center Program

93.703

ARRA - Grants to Health Center Programs

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: \$300,000

Auditee qualified as low-risk auditee? yes no

Esperanza Health Center, Inc.

**Schedule of Findings and Questioned Costs
Year Ended June 30, 2012**

Section II - Financial Statement Findings

IC 12-01 Books and Records

Criteria: The Center is required to maintain its records in order to prepare its financial statements in conformity with accounting principles generally accepted in the United States of America.

Statement of Condition: Some accounts were not reconciled until well after year-end and 30 post-closing journal entries were required to be made by management. Some adjusting entries for the year ended June 30, 2012 were provided by management as late as February 2013.

Questioned Costs: None.

Recommendation: We recommend that the Board and management monitor the month-end closing process in the current fiscal year to ensure that procedures are in place to confirm that accounts in the general ledger are being analyzed and reconciled throughout the year. This reconciliation will allow for more accurate interim reporting and avoid the necessity of a large number of post-closing entries at the end of the current fiscal year, as well as providing more timely and reliable financial information for management and the Board.

Management's Response: Management concurs with this recommendation and will be implementing procedures to confirm that accounts in the general ledger are being analyzed and reconciled throughout the year and to reduce the number of post-closing entries. The Finance Director has been tasked with implementing these procedures.

Section III - Findings and Questioned Costs for Federal Awards

CF 12-01 Allowable Cost and Applied Credits - United States Department of Health and Human Services, ARRA – Grants to Health Center Program (CFDA 93.703)

Criteria: Section A.5 of OMB Circular A-122 states that the term applicable credits refers to those receipts, or reduction of expenditures, which operate to offset or reduce expense items that are allocable to awards as direct or indirect costs. To the extent that such credits accruing or received by the organization relate to allowable cost, they shall be credited to the federal government either as a cost reduction or cash refund, as appropriate.

Statement of Condition: During 2012, the Center signed a lease for parking lot spaces at a neighboring building. The Center paid for certain improvements on that land, including fencing and crushed stone using federal funds. In exchange for those payments, the landlord gave the Center a rent credit.

Questioned Costs: \$21,317

Effect: We are unable to determine if all of the costs were allowable.

Recommendation: We recommend that the Center implement procedures to ensure that all applicable credits are credited to the federal grants.

Management's Response: Management concurs with this recommendation and will implement procedures to ensure that all applicable credits are credited to federal grants. The Finance Director has been tasked with implementing this corrective action plan, in consultation with the Operations Director, if necessary.

Esperanza Health Center, Inc.

**Summary Schedule of Prior Audit Findings
Year Ended June 30, 2012**

There were no prior audit findings.