

# **Mendocino Community Health Clinic, Inc.**

Accountants' Reports and Financial Statements

June 30, 2012 and 2011

**Mendocino Community Health Clinic, Inc.**  
**June 30, 2012 and 2011**

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## Independent Accountants' Report on Financial Statements and Supplementary Information

Board of Directors  
Mendocino Community Health Clinic, Inc.  
Ukiah, California

We have audited the accompanying balance sheets of Mendocino Community Health Clinic, Inc. (the "Organization") as of June 30, 2012 and 2011, and the related statements of operations, changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Mendocino Community Health Clinic, Inc. as of June 30, 2012 and 2011, and the results of its operations, the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in *Note 1*, in 2012 the Organization changed its method of presentation and disclosure of patient service revenue, provision for uncollectible accounts and the allowance for doubtful accounts in accordance with Accounting Standards Update 2011-07.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 15, 2013, on our consideration of the Organization's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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

*BKD, LLP*

February 15, 2013

# Mendocino Community Health Clinic, Inc.

## Balance Sheets

June 30, 2012 and 2011

### Assets

|  | <u>2012</u>          | <u>2011</u>          |
|--|----------------------|----------------------|
| <b>Current Assets</b>  |                      |                      |
| Cash and cash equivalents  | \$ 586,192           | \$ 509,088           |
| Patient accounts receivable, net of allowance;<br>2012 - \$1,254,000, 2011 - \$812,000 | 1,956,088            | 822,008              |
| Grants and other receivables   | 792,698              | 4,157                |
| Estimated amounts due from third-party payers  | 750,000              | 2,130,475            |
| Supplies   | 40,153               | 38,119               |
| Prepaid expenses and other   | <u>324,748</u>       | <u>309,333</u>       |
| Total current assets   | <u>4,449,879</u>     | <u>3,813,180</u>     |
| <b>Assets Limited As To Use</b>  |                      |                      |
| Externally restricted by lender  | <u>236,469</u>       | <u>205,652</u>       |
| <b>Property and Equipment, At Cost</b>   |                      |                      |
| Land and land improvements   | 1,343,246            | 1,343,246            |
| Buildings and leasehold improvements   | 7,167,228            | 7,472,742            |
| Equipment  | 1,722,307            | 1,729,970            |
| Construction in progress   | <u>2,049,951</u>     | <u>700,405</u>       |
|  | 12,282,732           | 11,246,363           |
| Less accumulated depreciation  | <u>4,254,343</u>     | <u>3,831,077</u>     |
|  | <u>8,028,389</u>     | <u>7,415,286</u>     |
| <b>Other Assets</b>  |                      |                      |
| Deposits   | <u>1,500</u>         | <u>3,500</u>         |
| Total assets   | <u>\$ 12,716,237</u> | <u>\$ 11,437,618</u> |

## Liabilities and Net Assets

|                                      | <u>2012</u>          | <u>2011</u>          |
|--------------------------------------|----------------------|----------------------|
| <b>Current Liabilities</b>           |                      |                      |
| Current maturities of long-term debt | \$ 563,381           | \$ 291,391           |
| Note payable to bank                 | 350,000              | 1,200,000            |
| Accounts payable                     | 666,330              | 327,040              |
| Accrued expenses                     | <u>1,322,302</u>     | <u>1,230,915</u>     |
| Total current liabilities            | 2,902,013            | 3,049,346            |
| <br>                                 |                      |                      |
| <b>Long-Term Debt</b>                | <u>4,771,007</u>     | <u>4,653,164</u>     |
| Total liabilities                    | <u>7,673,020</u>     | <u>7,702,510</u>     |
| <br>                                 |                      |                      |
| <b>Net Assets</b>                    |                      |                      |
| Unrestricted                         | 5,042,870            | 3,735,108            |
| Temporarily restricted               | <u>347</u>           | <u>-</u>             |
| Total net assets                     | <u>5,043,217</u>     | <u>3,735,108</u>     |
| Total liabilities and net assets     | <u>\$ 12,716,237</u> | <u>\$ 11,437,618</u> |

**Mendocino Community Health Clinic, Inc.**  
**Statements of Operations**  
**Years Ended June 30, 2012 and 2011**

|  | <b>2012</b>         | <b>2011<br/>(Adjusted -<br/>Note 1)</b> |
|--|---------------------|---|
| <b>Unrestricted Revenues, Gains and Other Support</b>                            |                     |   |
| Patient service revenue (net of contractual discounts and allowances)            | \$ 19,556,162       | \$ 18,257,789                           |
| Provision for uncollectible accounts   | <u>585,366</u>      | <u>503,923</u>                          |
| Net patient service revenue less provision for uncollectible accounts            | 18,970,796          | 17,753,866                              |
| Grant revenue  | 3,468,611           | 3,463,959                               |
| Contributions  | 96,008              | 140,743                                 |
| Other  | 813,008             | 59,199                                  |
| Net assets released from restriction used for operations                         | <u>8,500</u>        | <u>134,801</u>                          |
| Total unrestricted revenues, gains and other support                             | <u>23,356,923</u>   | <u>21,552,568</u>                       |
| <b>Expenses and Losses</b>   |                     |   |
| Salaries and wages   | 14,367,655          | 13,398,296                              |
| Employee benefits  | 2,801,031           | 2,622,306                               |
| Purchased services and professional fees   | 1,085,087           | 1,301,136                               |
| Supplies and other   | 3,786,958           | 3,247,014                               |
| Rent   | 117,285             | 104,052                                 |
| Depreciation and amortization  | 592,924             | 542,540                                 |
| Interest   | 281,301             | 272,833                                 |
| Loss on sale of property and equipment   | <u>186,825</u>      | <u>-</u>                                |
| Total expenses and losses  | <u>23,219,066</u>   | <u>21,488,177</u>                       |
| <b>Operating Income</b>  | 137,857             | 64,391                                  |
| <b>Other Income</b>  |                     |   |
| Investment return  | <u>706</u>          | <u>1,111</u>                            |
| <b>Excess of Revenues Over Expenses</b>  | 138,563             | 65,502                                  |
| Net assets released from restriction used for purchase of property and equipment | -                   | 54,624                                  |
| Grants for acquisition of property and equipment                                 | <u>1,169,199</u>    | <u>1,739,898</u>                        |
| <b>Increase in Unrestricted Net Assets</b>                                       | <u>\$ 1,307,762</u> | <u>\$ 1,860,024</u>                     |

**Mendocino Community Health Clinic, Inc.**  
**Statements of Changes in Net Assets**  
**Years Ended June 30, 2012 and 2011**

|   | <b>2012</b>  | <b>2011</b>  |
|---|--------------|--------------|
| <b>Unrestricted Net Assets</b>  |              |              |
| Excess of revenues over expenses  | \$ 138,563   | \$ 65,502    |
| Net assets released from restriction<br>used for purchase of property and equipment | -            | 54,624       |
| Grants for acquisition of property and equipment                                    | 1,169,199    | 1,739,898    |
| Increase in unrestricted net assets   | 1,307,762    | 1,860,024    |
| <b>Temporarily Restricted Net Assets</b>  |              |              |
| Contribution revenue  | 8,847        | 112,628      |
| Net assets released from restriction  | (8,500)      | (189,425)    |
| Increase (decrease) in temporarily restricted net assets                            | 347          | (76,797)     |
| <b>Change in Net Assets</b>   | 1,308,109    | 1,783,227    |
| <b>Net Assets, Beginning of Year</b>  | 3,735,108    | 1,951,881    |
| <b>Net Assets, End of Year</b>  | \$ 5,043,217 | \$ 3,735,108 |

**Mendocino Community Health Clinic, Inc.**  
**Statements of Cash Flows**  
**Years Ended June 30, 2012 and 2011**

|   | <u>2012</u>        | <u>2011</u>        |
|---|--------------------|--------------------|
| <b>Operating Activities</b>                                   |                    |                    |
| Change in net assets  | \$ 1,308,109       | \$ 1,783,227       |
| Items not requiring (providing) cash                          |                    |                    |
| Loss on sale of property and equipment                        | 186,825            | -                  |
| Depreciation and amortization                                 | 592,924            | 542,540            |
| Accrued litigation payable                                    | 825,000            | -                  |
| Grants for acquisition of property and equipment              | (1,169,199)        | (1,739,898)        |
| Changes in  |                    |                    |
| Patient accounts receivable, net                              | (1,134,080)        | 339,396            |
| Grants receivable   | (788,541)          | 18,179             |
| Estimated amounts due from and to third-party payers          | 1,380,475          | (1,030,475)        |
| Prepaid assets and other assets                               | (13,415)           | (105,496)          |
| Inventory and supplies  | (2,034)            | (1,144)            |
| Accounts payable and accrued expenses                         | 374,762            | 41,080             |
| Net cash provided by (used in) operating activities           | <u>1,560,826</u>   | <u>(152,591)</u>   |
| <b>Investing Activities</b>                                   |                    |                    |
| Purchase of assets limited as to use                          | (30,817)           | -                  |
| Proceeds from disposition of assets limited as to use         | -                  | 56,050             |
| Purchase of property and equipment                            | (1,339,104)        | (1,777,501)        |
| Proceeds from sale of property and equipment                  | 2,167              | -                  |
| Net cash used in investing activities                         | <u>(1,367,754)</u> | <u>(1,721,451)</u> |
| <b>Financing Activities</b>                                   |                    |                    |
| Proceeds from grant for acquisition of property and equipment | 1,169,199          | 1,739,898          |
| Principal payments on long-term debt                          | (435,167)          | (411,583)          |
| Proceeds from issuance of notes payable to bank               | 1,050,000          | 4,100,000          |
| Principal payments on notes payable to bank                   | (1,900,000)        | (3,250,000)        |
| Net cash provided by (used in) financing activities           | <u>(115,968)</u>   | <u>2,178,315</u>   |
| <b>Increase in Cash and Cash Equivalents</b>                  | 77,104             | 304,273            |
| <b>Cash and Cash Equivalents, Beginning of Year</b>           | <u>509,088</u>     | <u>204,815</u>     |
| <b>Cash and Cash Equivalents, End of Year</b>                 | <u>\$ 586,192</u>  | <u>\$ 509,088</u>  |
| <b>Supplemental Cash Flows Information</b>                    |                    |                    |
| Interest paid   | \$ 282,347         | \$ 277,939         |
| Accounts payable incurred for property and equipment          | \$ 55,915          | \$ -               |
| Litigation payable financed with long-term debt               | \$ 825,000         | \$ -               |

**Mendocino Community Health Clinic, Inc.**  
**Notes to Financial Statements**  
**June 30, 2012 and 2011**

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

***Nature of Operations***

Mendocino Community Health Clinic, Inc. (the “Organization”) is a federally qualified health center which provides health care and education services to patients. The Organization primarily earns revenues by providing physician and related health care services through clinics located in Ukiah, Willits and Lakeport, California.

***Use of Estimates***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

***Cash Equivalents***

The Organization considers all liquid investments, other than those limited as to use, with original maturities of three months or less to be cash equivalents. At June 30, 2012 and 2011, cash equivalents consisted primarily of money market deposit accounts.

Effective July 21, 2010, the FDIC’s insurance limits were permanently increased to \$250,000. At June 30, 2012, the Organization’s cash accounts exceeded federally insured limits by approximately \$1,250,000.

***Investment Return***

Investment return is comprised of interest income and is reported in the statement of operations.

***Assets Limited as to Use***

Assets limited as to use include assets restricted by loan requirements. Amounts required to meet current liabilities of the Organization are included in current assets.

***Change in Accounting Principle – ASU 2011-07***

In 2012, the Organization changed its method of presentation and disclosure of patient service revenue, provision for uncollectible accounts and the allowance for uncollectible accounts in accordance with Accounting Standards Update (ASU) 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts and the Allowance for Doubtful Accounts for Certain Health Care Entities*. The major changes associated with ASU 2011-07 are to reclassify

# Mendocino Community Health Clinic, Inc.

## Notes to Financial Statements

June 30, 2012 and 2011

the provision for uncollectible accounts related to patient service revenue to a deduction from patient service revenue and to provide enhanced disclosures around the Organization's policies related to uncollectible accounts. The change had no effect on prior year change in net assets.

|  | <b>As<br/>Adjusted</b> | <b>As<br/>Previously<br/>Reported</b> | <b>Effect of<br/>Change</b> |
|--|------------------------|---------------------------------------|-----------------------------|
| Provision for uncollectible accounts                                     | \$ (503,923)           | \$ -                                  | \$ (503,923)                |
| Net patient service revenue less<br>provision for uncollectible accounts | \$ 17,753,866          | \$ 18,257,789                         | \$ (503,923)                |
| Total expenses and losses  | \$ 21,488,177          | \$ 21,992,100                         | \$ (503,923)                |

### ***Patient Accounts Receivable***

Accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectability of accounts receivable, the Organization analyzes its past history and identifies trends for each of its major payer sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for uncollectible accounts. Management regularly reviews data about these major payer sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts.

For receivables associated with services provided to patients who have third-party coverage, the Organization analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for uncollectible accounts, if necessary (for example, for expected uncollectible deductibles and copayments on accounts for which the third-party payer has not yet paid, or for payers who are known to be having financial difficulties that make the realization of amounts due unlikely).

For receivables associated with self-pay patients (which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), the Organization records a significant provision for uncollectible accounts in the period of services on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates if negotiated or provided by the sliding fee or other policy) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

The Organization's allowance for doubtful accounts for self-pay patients increased from 64% of self-pay accounts receivable at June 30, 2011 to 86% of self-pay accounts receivable at June 30, 2012. In addition, the Organization's write-offs decreased approximately \$85,000 from approximately \$228,000 for the year ended June 30, 2011, to approximately \$143,000 for the year ended June 30, 2012. The decrease was the result of the Organization sending self-pay accounts to an intermediary collection agency before writing them off and filing them with their terminal collection agency.

# **Mendocino Community Health Clinic, Inc.**

## **Notes to Financial Statements**

**June 30, 2012 and 2011**

### ***Supplies***

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

### ***Property and Equipment***

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

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

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

### ***Long-Lived Asset Impairment***

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

No asset impairment was recognized during the years ended June 30, 2012 and 2011.

### ***Temporarily Restricted Net Assets***

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

### ***Net Patient Service Revenue***

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

# **Mendocino Community Health Clinic, Inc.**

## **Notes to Financial Statements**

**June 30, 2012 and 2011**

### ***Contributions***

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

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

### ***Government Grant Revenue***

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

### ***Income Taxes***

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

### ***Electronic Health Records Incentive Program***

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

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

# Mendocino Community Health Clinic, Inc.

## Notes to Financial Statements

June 30, 2012 and 2011

In 2012, the Organization completed the first-year requirements under the Medicaid program for certain providers and has recorded revenue of \$680,000, which is included in other revenue in the statements of operations.

### ***Excess of Revenues Over Expenses***

The statements of operations include excess of revenues over expenses. Changes in unrestricted net assets which are excluded from excess of revenues 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).

### ***Subsequent Events***

Subsequent events have been evaluated through the date of the Independent Accountants' Report, which is the date the financial statements were available to be issued.

### **Note 2: Grant Revenue**

The Organization is the recipient of a Consolidated Health Centers (CHC) grant from the U.S. Department of Health and Human Services. The general purpose of the grant is to provide expanded health care service delivery in Ukiah, California, and surrounding areas. Terms of the grant generally provide for funding of the Organization's operations based on an approved budget. Grant revenue is recognized as qualifying expenditures are incurred over the grant period. During the years ended June 30, 2012 and 2011, the Organization received \$2,992,505 and \$2,838,738 in CHC grant funds, respectively. Funding for the grant year ending December 31, 2012, is approved at \$2,992,499.

The Organization is the recipient of a grant to provide outpatient early intervention services for HIV disease from the U.S. Department of Health and Human Services. The general purpose of the grant is to provide expanded HIV intervention services in Ukiah, California, and surrounding areas. Terms of the grant generally provide for funding of the Organization's operations related to provision of expanded HIV care based on an approved budget. Grant revenue is recognized as qualifying expenditures are incurred over the grant period. During the years ended June 30, 2012 and 2011, the Organization received \$476,108 and \$476,110 in grant funds, respectively.

The Organization has been awarded \$4,968,447 under the Affordable Care Act (ACA) - Capital Development Grants for the October 1, 2010, to September 30, 2013, period to fund the current construction and renovations taking place within the Organization. During the years ended June 30, 2012 and 2011, the Organization recognized \$1,115,960 and \$423,897, respectively, in ACA grant funds.

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

# Mendocino Community Health Clinic, Inc.

## Notes to Financial Statements

June 30, 2012 and 2011

### Note 3: Net Patient Service Revenue

The Organization recognizes patient service revenue associated with services provided to patients who have third-party payer coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for the sliding fee program, the Organization recognizes revenue on the basis of its standard rates for services provided. On the basis of historical experience, a significant portion of the Organization's uninsured patients who do not qualify for the sliding fee program will be unable or unwilling to pay for the services provided. Thus, the Organization records a significant provision for uncollectible accounts related to uninsured patients who do not qualify for the sliding fee program in the period the services are provided. This provision for uncollectible accounts is presented on the statement of operations as a component of net patient service revenue.

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

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

*Medi-Cal.* Covered FQHC services rendered to Medi-Cal program beneficiaries are paid on the basis of per visit rates. The Organization is reimbursed on a prospective basis, and no additional settlement will be made on the difference between per visit rates paid and actual costs.

The Organization is required to submit an annual Medi-Cal Reconciliation Request Form to the California Department of Health Care Services (the "Department") for purposes of determining whether it was paid appropriately for certain Medi-Cal visits. These annual reconciliations result in the determination of any underpayment or overpayment by the Medi-Cal program for the affected visits. The Organization has recorded a receivable for estimated settlements expected to be received for Medi-Cal Reconciliation Request Forms for the years ended June 30, 2012, 2011 and 2010. Such amounts are recorded on the balance sheets as estimated amounts due from third-party payers.

The 2012 net patient service revenue increased by approximately \$310,000 due to changes in estimates related to annual Medi-Cal Reconciliation Request Forms for dates of service prior to July 1, 2011.

The 2011 net patient service revenue increased by approximately \$740,000 due to changes in estimates related to annual Medi-Cal Reconciliation Request Forms for dates of service prior to July 1, 2010.

# Mendocino Community Health Clinic, Inc.

## Notes to Financial Statements

June 30, 2012 and 2011

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

The Organization has also entered into payment agreements with certain commercial insurance carriers. The basis for payment to the Organization under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

Patient service revenue, net of contractual allowances and discounts (but before the provision for uncollectible accounts), recognized in the years ended June 30, 2012 and 2011, was approximately:

|                                       | <b>2012</b>          | <b>2011</b>          |
|---------------------------------------|----------------------|----------------------|
| Medicare                              | \$ 3,706,426         | \$ 2,439,408         |
| Medicaid                              | 10,086,557           | 11,070,529           |
| Other third-party payers and patients | 5,763,179            | 4,747,852            |
|                                       | <u>\$ 19,556,162</u> | <u>\$ 18,257,789</u> |

### Note 4: Concentration of Credit Risk

The Organization grants credit without collateral to its patients, most of whom are area residents and are insured under third-party payer agreements. The mix of receivables from patients and third-party payers at June 30, 2012 and 2011, was:

|                          | <b>2012</b> | <b>2011</b> |
|--------------------------|-------------|-------------|
| Medicare                 | 10%         | 9%          |
| Medi-Cal                 | 67%         | 36%         |
| Other third-party payers | 23%         | 55%         |
|                          | <u>100%</u> | <u>100%</u> |

# Mendocino Community Health Clinic, Inc.

## Notes to Financial Statements

June 30, 2012 and 2011

### Note 5: Assets Limited as to Use

Assets limited as to use include:

|                                 | 2012       | 2011       |
|---------------------------------|------------|------------|
| Externally restricted by lender |            |            |
| Cash                            | \$ 236,469 | \$ 205,652 |

### Note 6: Medical Malpractice Claims

The U.S. Department of Health and Human Services has deemed the Organization and its participating providers covered under the Federal Torts Claims Act (FTCA) for damage for personal injury, including death, resulting from the performance of medical, surgical, dental and related functions. FTCA coverage is comparable to an occurrence policy without a monetary cap.

In 2012, the Organization adopted the provisions of Accounting Standards Update (ASU) 2010-24 *Health Care Entities (Topic 954): Presentation of Insurance Claims and Related Insurance Recoveries*, which eliminates the practice of netting claim liabilities with expected insurance recoveries for balance sheet presentation. Claim liabilities are to be determined without consideration of insurance recoveries. Expected recoveries are presented separately. Prior to the adoption of ASU 2010-24, accounting principles generally accepted in the United States of America require a health care provider to accrue only an estimate of the malpractice claims cost for both reported claims and claims incurred but not reported where the risk of loss had not been transferred to a financially viable insurer. There was no impact of the ASU adoption to the Organization's financial statements.

Based upon the Organization's claim experience, no such accrual has been made for the Organization's medical malpractice cost for the years ended June 30, 2012 and 2011. However, because of the risk in providing health care services, it is possible that an event has occurred which will be the basis of a future medical claim.

### Note 7: Temporarily Restricted Net Assets

Temporarily restricted net assets are available for the following purpose:

|                      | 2012   | 2011 |
|----------------------|--------|------|
| Health care services | \$ 347 | \$ - |

During 2012 and 2011, net assets were released from donor restrictions by incurring expenses, satisfying the restricted purposes in the amount of \$8,500 and \$189,425, respectively.

# Mendocino Community Health Clinic, Inc.

## Notes to Financial Statements

June 30, 2012 and 2011

### Note 8: Note Payable to Bank

The Organization has a \$2,000,000 revolving bank line of credit expiring on February 26, 2013. At June 30, 2012 and 2011, there was \$350,000 and \$1,200,000, respectively, borrowed against this line. The line is collateralized by substantially all of the Organization's assets. Interest varies with the bank's prime rate, plus 3.25%, which was 6.5% on June 30, 2012, and is payable monthly. Principal payments totaling \$350,000 were made subsequent to year end.

### Note 9: Long-Term Debt

|   | 2012         | 2011         |
|---|--------------|--------------|
| United States Department of Agriculture, Hillside (A)             | \$ 1,520,899 | \$ 1,566,926 |
| United States Department of Agriculture, Lakeside (B)             | 829,813      | 862,624      |
| United States Department of Agriculture, Little Lake (C)          | 684,860      | 703,239      |
| Rural Community Assistance Corporation (D)                        | 735,055      | 747,624      |
| Savings Bank of Mendocino (E)                                     | 10,777       | 20,880       |
| California Department of Health Services, Hillside (F)            | 476,091      | 529,354      |
| California Department of Health Services, Lakeside (G)            | 221,480      | 250,494      |
| California Department of Health Services, Little Lake (H)         | 165,180      | 186,354      |
| California Department of Health Services, FY2004 (I)              | -            | 53,288       |
| County Medical Services Program (J)                               | 681,250      | -            |
| Capital Lease Obligations - Cisco Systems Capital Corporation (K) | 8,983        | 23,772       |
|   | 5,334,388    | 4,944,555    |
| Less current maturities   | 563,381      | 291,391      |
|   | \$ 4,771,007 | \$ 4,653,164 |

- (A) Due July 2032; payable \$9,633 monthly including interest at 4.50%; secured by certain real estate and the gross income and revenue derived from the operation of the real estate.

The loan agreement requires that certain funds be established with the lender. Accordingly, these funds are included as assets limited as to use, externally restricted by lender in the financial statements. The loan agreement also requires the Organization to comply with certain restrictive covenants including minimum insurance coverage and restrictions on incurrence of additional debt.

- (B) Due April 2030; payable \$5,923 monthly including interest at 4.50%; secured by certain real estate and the gross income and revenue derived from the operation of the real estate.

# Mendocino Community Health Clinic, Inc.

## Notes to Financial Statements

June 30, 2012 and 2011

The loan agreement requires that certain funds be established with the lender. Accordingly, these funds are included as assets limited as to use, restricted by lender in the financial statements. The loan agreement also requires the Organization to comply with certain restrictive covenants including minimum insurance coverage and restrictions on incurrence of additional debt.

- (C) Due June 2034; payable \$4,065 monthly including interest at 4.375%; secured by certain real estate and the gross income and revenue derived from the operation of the real estate.

The loan agreement requires that certain funds be established with the lender. Accordingly, these funds are included as assets limited as to use, restricted by lender in the financial statements. The loan agreement also requires the Organization to comply with certain restrictive covenants including minimum insurance coverage and restrictions on incurrence of additional debt.

- (D) Due July 2034; payable \$5,685 monthly including interest at 7.50%; secured by certain real estate.
- (E) Due June 2013; payable \$937 monthly including interest at 6.99%; secured by a vehicle.
- (F) Due August 2020; payable \$5,278 monthly including interest at 1.995%; secured by Medi-Cal billings.
- (G) Due July 2019; payable \$2,785 monthly including interest at 1.859%; secured by Medi-Cal billings.
- (H) Due September 2019; payable \$2,058 monthly including interest at 1.995%; secured by Medi-Cal billings.
- (I) Due December 2011; payable \$9,219 monthly including interest at 5.235%; secured by Medi-Cal billings. Balance was paid in full during the fiscal year.
- (J) Due February 2014; payable \$31,250 monthly thru February 2013 and \$26,042 thereafter; secured by CMSP billings. Additional estimated liability included of \$150,000 due in part July 2013 and 2014. The Community Medical Services Program loan was incurred as final settlement of a historical claims settlement. See *Note 14* for settlement of litigation.
- (K) At imputed interest of 4.5%, due January 2013; collateralized by property and equipment.

Property and equipment include the following property under capital leases:

|                               | 2012      | 2011      |
|-------------------------------|-----------|-----------|
| Equipment                     | \$ 61,464 | \$ 61,464 |
| Less accumulated depreciation | 59,757    | 39,269    |
|                               | \$ 1,707  | \$ 22,195 |

**Mendocino Community Health Clinic, Inc.**  
**Notes to Financial Statements**  
**June 30, 2012 and 2011**

The California Department of Health Services loans were incurred as final settlement of cost reports for the years ended June 30, 2000, and June 30, 2001, and the Reports on Reconciliation Review for the years ended June 30, 2002, June 30, 2003, and June 30, 2004.

Aggregate annual maturities of long-term debt and payments on capital lease obligations at June 30, 2012, are:

|  |    | <b>Long-Term<br/>Debt<br/>(Excluding<br/>Capital Lease<br/>Obligations)</b> | <b>Capital<br/>Lease<br/>Obligations</b> |
|--|----|---|--|
|  |    |   |  |
| 2013   | \$ | 554,398   | \$ 9,090                                 |
| 2014   |    | 511,814   | -  |
| 2015   |    | 311,596   | -  |
| 2016   |    | 245,063   | -  |
| 2017   |    | 253,900   | -  |
| Thereafter                                     |    | 3,448,634   | -  |
|  |    | \$ 5,325,405  | 9,090                                    |
| Less amount representing interest              |    |   | 107                                      |
| Present value of future minimum lease payments |    |   | 8,983                                    |
| Less current maturities                        |    |   | 8,983                                    |
| Noncurrent portion                             |    |   | \$ -                                     |

**Note 10: Functional Expenses**

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

|                            | <b>2012</b>   | <b>2011</b>   |
|----------------------------|---------------|---------------|
|                            |               |               |
| Health care services       | \$ 16,203,630 | \$ 14,194,498 |
| General and administrative | 7,015,436     | 7,293,679     |
|                            | \$ 23,219,066 | \$ 21,488,177 |

# Mendocino Community Health Clinic, Inc.

## Notes to Financial Statements

June 30, 2012 and 2011

### Note 11: Operating Leases

The Organization has noncancellable operating leases for equipment which expire in various years through 2015.

Future minimum lease payments at June 30, 2012, were:

|                               |                          |
|-------------------------------|--------------------------|
| 2013                          | \$ 124,339               |
| 2014                          | 48,697                   |
| 2015                          | <u>9,030</u>             |
| Future minimum lease payments | <u><u>\$ 182,066</u></u> |

### Note 12: Construction in Progress

At June 30, 2012, the Organization had four projects outstanding. The Hillside project is expected to be completed in phases during calendar year 2012 at a cost of approximately \$3,250,000. The Lakeside project is expected to be completed in March 2013 at a cost of approximately \$1,500,000. The Little Lake project was completed in July 2012 at a cost of approximately \$190,000. The electronic dental records project was completed in December 2012 at a cost of approximately \$650,000. The Organization financed these projects through a combination of grant funds and internally generated funds.

### Note 13: Pension Plan

The Organization has a defined contribution pension plan covering substantially all employees. The Board of Trustees annually determines the amount, if any, of the Organization's contributions to the plan. The Organization made no contributions for 2012 and 2011.

### Note 14: Significant Estimates and Concentrations

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

#### **Grant Awards**

Concentration of revenues related to grant awards and other support are described in *Notes 1* and *2*.

# **Mendocino Community Health Clinic, Inc.**

## **Notes to Financial Statements**

**June 30, 2012 and 2011**

### ***Allowance for Net Patient Service Revenue Adjustments***

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

### ***Malpractice Claims***

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

### ***Litigation***

The Organization participated in the County Medical Services Program (CMSP); a program in which eligible counties may elect to participate to provide health coverage for low-income, indigent adults in those participating counties. CMSP is managed by a Governing Board which is established by the participating counties and consists of representative county officials from the participating counties.

From 1998 to 2005, the Organization provided federally qualified health care services to patients suffering from narcotics addiction in Mendocino County. The Organization submitted claims to CMSP for payment for services rendered to CMSP patients in this program. CMSP paid submitted claims during those seven years. In 2007, CMSP filed an action alleging that the services were never covered, that the Organization purportedly fraudulently billed CMSP and that CMSP mistakenly paid the bills. CMSP has asserted claims for common count, misrepresentation and violation of the California False Claims Act. CMSP does not allege that the Organization made any false statement in its billings submitted to CMSP, only that the services were not deemed by CMSP to be covered by its program.

While the organization disputes all of CMSP's claims, to avoid additional future costs of continued litigation, a final settlement was reached in fiscal 2012 with CMSP. The outstanding balance is recorded as long-term debt and terms are described in *Note 9*.

### ***Current Economic Conditions***

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

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

# **Mendocino Community Health Clinic, Inc.**

## **Notes to Financial Statements**

**June 30, 2012 and 2011**

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

The Organization continues to take steps to address these possible future negative impacts on their financial position which include filing for enhanced Medi-Cal reimbursement, plans to increase patient volume and cost reduction efforts.

## **Supplementary Information**

**Mendocino Community Health Clinic, Inc.**  
**Schedule of Expenditures of Federal Awards**  
**Year Ended June 30, 2012**

| Cluster/Program  | Federal Agency/<br>Pass-Through<br>Entity   | CFDA<br>Number | Grant or<br>Identifying<br>Number | Amount<br>Expended  |
|--|---|----------------|-----------------------------------|---------------------|
| Consolidated Health Centers  | U.S. Department of Health<br>and Human Services   | 93.224         | 6 H80 CS<br>00628-10-03           | \$ 325,012          |
| Consolidated Health Centers  | U.S. Department of Health<br>and Human Services   | 93.224         | 6 H80 CS<br>00628-11-03           | 883,579             |
| Affordable Care Act Grants for<br>New and Expanded Services<br>Under the Health Center Program | U.S. Department of Health<br>and Human Services   | 93.527         | 6 H80 CS<br>00628-10-03           | 1,166,865           |
| Affordable Care Act Grants for<br>New and Expanded Services<br>Under the Health Center Program | U.S. Department of Health<br>and Human Services   | 93.527         | 6 H80 CS<br>00628-11-03           | <u>617,049</u>      |
|  |   |                |                                   | <u>2,992,505</u>    |
| Grants to Provide Outpatient<br>Early Intervention Services<br>with Respect to HIV Disease     | U.S. Department of Health<br>and Human Services   | 93.918         | 5 H76HA<br>00170-16-00            | 238,055             |
| Grants to Provide Outpatient<br>Early Intervention Services<br>with Respect to HIV Disease     | U.S. Department of Health<br>and Human Services   | 93.918         | 6 H76HA<br>00170-17-02            | <u>238,053</u>      |
|  |   |                |                                   | <u>476,108</u>      |
| Affordable Care Act<br>Capital Development Grants  | U.S. Department of Health<br>and Human Services   | 93.526         | 6 C8A CS<br>21248-01-02           | <u>1,115,960</u>    |
| ARRA - Health Information<br>Technology Implementation   | U.S. Department of Health<br>and Human Services /<br>Alliance for Rural<br>Community Health                                   | 93.703         |                                   | <u>31,635</u>       |
| Health Information Technology<br>Regional Extension Centers Program                            | U.S. Department of Health<br>and Human Services /<br>California Health<br>Information Partnership<br>and Service Organization | 93.718         | 90RC0031/34                       | <u>21,604</u>       |
|  |   |                |                                   | <u>\$ 4,637,812</u> |

**Mendocino Community Health Clinic, Inc.**  
**Schedule of Expenditures of Federal Awards**  
**Year Ended June 30, 2012**

***Notes to Schedule***

1. This schedule includes the federal awards activity of Mendocino Community Health Clinic, Inc. and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.
2. Mendocino Community Health Clinic, Inc. did not provide federal awards to subrecipients during the year ended June 30, 2012.

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

Board of Directors  
Mendocino Community Health Clinic, Inc.  
Ukiah, California

We have audited the financial statements of Mendocino Community Health Clinic, Inc. (the "Organization") as of and for the year ended June 30, 2012, and have issued our report thereon dated February 15, 2013, which contained an explanatory paragraph regarding a change in accounting principle. 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 Organization is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Organization's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Organization's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Organization's internal control over financial reporting.

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

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Organization's financial statements will not be prevented or detected and corrected on a timely basis. We consider the deficiency described in the accompanying schedule of findings and questioned costs as item 12-01 to be a material weakness.

Board of Directors  
Mendocino Community Health Clinic, Inc.

### ***Compliance and Other Matters***

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

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

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

**BKD, LLP**

February 15, 2013

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

Board of Directors  
Mendocino Community Health Clinic, Inc.  
Ukiah, California

### **Compliance**

We have audited the compliance of Mendocino Community Health Clinic, Inc. (the "Organization") with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that could have a direct and material effect on its major federal program for the year ended June 30, 2012. The Organization's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to its major federal program is the responsibility of the Organization's management. Our responsibility is to express an opinion on the compliance of Mendocino Community Health Clinic, Inc. based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Organization's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Organization's compliance with those requirements.

As described in item 12-02 in the accompanying schedule of findings and questioned costs, the Organization did not comply with requirements regarding Special Tests and Provisions: Section 340B Drug Pricing Program that are applicable to its Health Centers Cluster program. Compliance with such requirements is necessary, in our opinion, for the Organization to comply with requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, Mendocino Community Health Clinic, Inc. complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended June 30, 2012.

Board of Directors  
Mendocino Community Health Clinic, Inc.

### ***Internal Control Over Compliance***

The management of Mendocino Community Health Clinic, Inc. is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Organization's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Organization's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses.

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. We consider the deficiency in internal control over compliance described in the accompanying schedule of findings and questioned costs as item 12-02 to be a material weakness.

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

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

*BKD, LLP*

February 15, 2013



**Mendocino Community Health Clinic, Inc.**  
**Schedule of Findings and Questioned Costs**  
**Year Ended June 30, 2012**

8. The threshold used to distinguish between Type A and Type B programs as those terms are defined in OMB Circular A-133 was \$300,000.
9. The Organization qualified as a low-risk auditee as that term is defined in OMB Circular A-133.  Yes  No

**Mendocino Community Health Clinic, Inc.**  
**Schedule of Findings and Questioned Costs**  
**Year Ended June 30, 2012**

**Findings Required to be Reported by *Government Auditing Standards***

| Reference Number | Finding   | Questioned Costs |
|------------------|---|------------------|
| 12-01            | <p>Criteria or Specific Requirement – Management is responsible for establishing and maintaining effective internal control over external financial reporting.</p> <p>Condition – The Organization’s financial statements required adjustments to be in conformity with generally accepted accounting principles. Areas in which adjustments were proposed, including those which management recorded, include:</p> <ul style="list-style-type: none"> <li>• Accounts receivables and related revenue</li> </ul> <p>Additionally the Organization does not have a formal process for calculating allowances for uncollectible accounts.</p> <p>Context – The Organization’s financial statements should be presented in conformity with generally accepted accounting principles.</p> <p>Effect – Financial statements were presented to the Board of Directors with misstatements.</p> <p>Cause – The Organization did not have a formal process for calculating the net realizable value of patient accounts receivable resulting in a necessary adjustment to present the financial statements in accordance with generally accepted accounting principles.</p> <p>Recommendation – Management should modify month-end closing procedures to ensure controls in place are sufficient to assure financial statements are prepared in accordance with generally accepted accounting principles.</p> <p>Views of Responsible Officials and Planned Corrective Actions –Mendocino Community Health Clinic, Inc. is in the process of reviewing its closing procedures as they relate to net realizable value of patient accounts receivables and is using consultants from NextGen and BKD, LLP in order to determine how to make the practice management system work more effectively to assist in determining the end of month balances throughout the year. We have attempted to study the historic adjustments required to comply with GAAP with some success, but this had not had the effect for which we hoped. Consequently we are actively working toward revisions in our accounting and billing processes which we hope will prevent human error and utilizing information from consultants who have expertise in the NextGen system and can offer advice on the changes to the system that will be required to accomplish the required revision. This process is ongoing and involves personnel from Finance, Billing and Informatics.</p> | None             |

**Mendocino Community Health Clinic, Inc.**  
**Schedule of Findings and Questioned Costs**  
**Year Ended June 30, 2012**

**Findings Required to be Reported by OMB Circular A-133**

| Reference Number | Finding | Questioned Costs |
|------------------|---------|------------------|
|------------------|---------|------------------|

|       |  |      |
|-------|--|------|
| 12-02 | Health Center Clusters<br>CFDA No. 93.224 and 93.527<br>U.S. Department of Health and Human Services<br>Award No. 6 H80 CS 00628-10-03 & 6 H80 CS 0062-11-03 | None |
|-------|--|------|

Criteria or Specific Requirement – Special Tests and Provisions:  
 Section 340B Drug Pricing Program

Condition – Section 340B(a)(5)(B) of the Public Health Services Act prohibits covered entities such as the Organization from selling, transferring or giving covered outpatient drugs to anyone other than patients of the covered entity. Covered entities must also maintain auditable records documenting compliance with 340B Drug Pricing Program requirements. Covered entities are subject to audit by manufactures or the federal government. Any covered entity that fails to comply with program requirements may be liable to manufacturers for refunds of the discount obtained.

Context – During the year ended June 30, 2012, the Organization operated two 340B Drug Pricing Programs, contract and in-house. The Organization was unable to provide detailed support of drugs distributed from the in-house pharmacy inventory due to antiquated inventory tracking systems.

Effect – 340B drugs could have been diverted. Controls over pharmaceuticals distributed by the in-house pharmacy under the Section 340B Drug Pricing Program to patients seen by prescribers at the Organization were not sufficient to determine if the population of drug disbursement was complete. Limited testing of disbursements from the income population did not hold any evidence that diversion of drugs occurred.

Cause – The current pharmaceutical system used by the in-house pharmacy does not track all of the drugs disbursed from inventory. Additionally, drugs disbursed per the pharmacy system are not reconciled to the general ledger. Current tracking methodologies for purchases do not allow for the segregation of drug purchases for use by the in-house pharmacy from the supply purchases used by providers in the clinics.

**Mendocino Community Health Clinic, Inc.**  
**Schedule of Findings and Questioned Costs**  
**Year Ended June 30, 2012**

**Findings Required to be Reported by OMB Circular A-133**

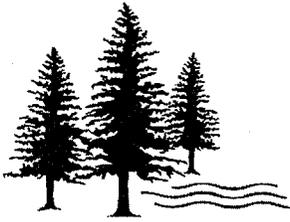
| Reference<br>Number  | Finding  | Questioned<br>Costs |
|----------------------|--|---------------------|
| 12-02<br>(Continued) | <p>Recommendation – The Organization should develop formal policies and procedures applicable to the 340B Drug Pricing Program to ensure compliance with program requirements.</p> <p>Views of Responsible Officials and Planned Corrective Actions – Management of the Organization is in the process of adding the inventory module to the current accounting system. This addition will allow the tracking of both inventory flow and costs according to GAAP and compliance requirements. Additionally management is attempting to segregate drug purchases and inventories from supply purchases and inventories therefore refining the Organization’s ability to calculate the correct costs in the inventories. The Pharmacy Director currently tracks drugs disbursed to individual patients manually and this tracking will be shared with the Finance Department therefore becoming the basis for the usage of the drug inventory.</p> | None                |

**Mendocino Community Health Clinic, Inc.**  
**Summary Schedule of Prior Audit Findings**  
**Year Ended June 30, 2012**

| <b>Reference<br/>Number</b> | <b>Finding</b> | <b>Status</b> |
|-----------------------------|----------------|---------------|
|-----------------------------|----------------|---------------|

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No matters are reportable.



**MENDOCINO COMMUNITY HEALTH CLINIC, INC.**  
An independent nonprofit healthcare corporation serving Lake and Mendocino Counties.

February 15, 2013

The following summarizes our corrective actions related to the findings reported to our Board of Directors pursuant to our audit of the fiscal year ended June 30, 2012:

**Finding:** Adjustments were required to the Accounts Receivable in order for the financial statements to be in conformity with GAAP:

**Planned Corrective Action:** Mendocino Community Health Clinic, Inc. is in the process of reviewing its closing procedures as they relate to net realizable value of patient accounts receivable and is using consultants from NextGen and BKD, LLP in order to determine how to make the practice management system work more effectively to assist in determining the end of month balances throughout the year. We have attempted to study the historic adjustments required to conform with GAAP with some success, but this had not had the effect for which we hoped. Consequently we are actively working toward revisions in our accounting and billing processes which we hope will prevent human error and utilizing information from consultants who have expertise in the NextGen system and can offer advice on the changes to the system that will be required to accomplish the required revision. This process is ongoing and involves personnel in Finance, Billing and Informatics.

**Finding:** Controls over pharmaceuticals distributed by the in-house pharmacy under the Section 340B Drug Pricing Program were not sufficient to determine if the population of drug disbursement were complete:

**Planned Corrective Action:** Management is in the process of adding the inventory module to its current accounting system. This addition will allow tracking of both inventory flow and costs according to GAAP and compliance requirements. Additionally management is attempting to segregate drug purchases from supply purchases and inventories therefore refining the Organization's ability to calculate the correct costs in the inventories. The Pharmacy Director currently tracks drugs disbursed to individual patients manually and this tracking will be shared with the Finance Department therefore becoming the basis for the usage of the drug inventory.

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*At three community-based health centers, MCHC ensures access to quality care for the most vulnerable people in our community.*

Hillside Health Center  
333 Laws Avenue  
Ukiah, CA 95482  
(707) 468-1010

Lakeside Health Center  
5335 Lakeshore Boulevard  
Lakeport, CA 95453  
(707) 263-7725

Little Lake Health Center  
45 Hazel Street  
Willits, CA 95490  
(707) 456-9600