

Mendocino Community Health Clinic, Inc.

Independent Auditor's Reports and Financial Statements

June 30, 2014 and 2013

Mendocino Community Health Clinic, Inc.
June 30, 2014 and 2013

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Independent Auditor's Report

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

Report on the Financial Statements

We have audited the accompanying financial statements of Mendocino Community Health Clinic, Inc. (the "Organization"), which comprise the balance sheets as of June 30, 2014 and 2013, and the related statements of operations, changes in net assets and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

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, 2014 and 2013, and the results of its operations, the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Supplementary Information

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

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated February 20, 2015, 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* in considering Mendocino Community Health Clinic, Inc.'s internal control over financial reporting and compliance.

BKD, LLP

Springfield, Missouri
February 20, 2015

Mendocino Community Health Clinic, Inc.

Balance Sheets

June 30, 2014 and 2013

Assets

	<u>2014</u>	<u>2013</u>
Current Assets		
Cash and cash equivalents	\$ 955,022	\$ 1,225,013
Patient accounts receivable, net of allowance; 2014 - \$1,679,000, 2013 - \$1,314,000	2,537,431	2,117,752
Grants and other receivables	244,247	404,449
Estimated amounts due from third-party payers	100,000	90,000
Supplies	53,836	48,193
Prepaid expenses and other	<u>310,650</u>	<u>169,879</u>
Total current assets	<u>4,201,186</u>	<u>4,055,286</u>
Assets Limited As To Use		
Externally restricted by lender	<u>229,980</u>	<u>236,587</u>
Property and Equipment, At Cost		
Land and land improvements	1,823,845	1,343,246
Buildings and leasehold improvements	10,987,160	8,505,105
Equipment	3,022,673	2,959,415
Construction in progress	<u>164,587</u>	<u>2,001,626</u>
	15,998,265	14,809,392
Less accumulated depreciation	<u>5,978,641</u>	<u>5,085,665</u>
	<u>10,019,624</u>	<u>9,723,727</u>
Other Assets		
Deposits	<u>5,411</u>	<u>2,000</u>
Total assets	<u>\$ 14,456,201</u>	<u>\$ 14,017,600</u>

Liabilities and Net Assets

	<u>2014</u>	<u>2013</u>
Current Liabilities		
Current maturities of long-term debt	\$ 236,163	\$ 436,399
Accounts payable	748,071	820,063
Accrued expenses	<u>1,518,042</u>	<u>1,434,650</u>
Total current liabilities	2,502,276	2,691,112
Long-Term Debt	<u>3,959,749</u>	<u>4,291,941</u>
Total liabilities	<u>6,462,025</u>	<u>6,983,053</u>
Net Assets		
Unrestricted	7,919,176	7,034,195
Temporarily restricted	<u>75,000</u>	<u>352</u>
Total net assets	<u>7,994,176</u>	<u>7,034,547</u>
Total liabilities and net assets	<u>\$ 14,456,201</u>	<u>\$ 14,017,600</u>

Mendocino Community Health Clinic, Inc.
Statements of Operations
Years Ended June 30, 2014 and 2013

	2014	2013
Unrestricted Revenues, Gains and Other Support		
Patient service revenue (net of contractual discounts and allowances)	\$ 22,936,531	\$ 20,599,617
Provision for uncollectible accounts	255,000	256,102
Net patient service revenue less provision for uncollectible accounts	22,681,531	20,343,515
Grant revenue	3,701,868	3,543,244
Contributions	36,460	153,656
Other	627,706	823,578
Net assets released from restriction used for operations	68,852	8,500
Total unrestricted revenues, gains and other support	27,116,417	24,872,493
Expenses and Losses		
Salaries and wages	16,129,025	15,622,243
Employee benefits	3,612,699	3,188,426
Purchased services and professional fees	1,217,589	1,011,358
Supplies and other	4,855,261	4,280,361
Rent	193,435	171,717
Depreciation and amortization	956,441	881,220
Interest	197,052	208,688
(Gain) loss on sale of property and equipment	70,681	(15,200)
Total expenses and losses	27,232,183	25,348,813
Operating Loss	(115,766)	(476,320)
Other Income		
Investment return	2,288	1,514
Deficiency of Revenues Over Expenses	(113,478)	(474,806)
Grants for acquisition of property and equipment	998,459	2,466,131
Increase in Unrestricted Net Assets	\$ 884,981	\$ 1,991,325

Mendocino Community Health Clinic, Inc.
Statements of Changes in Net Assets
Years Ended June 30, 2014 and 2013

	2014	2013
Unrestricted Net Assets		
Deficiency of revenues over expenses	\$ (113,478)	\$ (474,806)
Grants for acquisition of property and equipment	998,459	2,466,131
Increase in unrestricted net assets	884,981	1,991,325
Temporarily Restricted Net Assets		
Contributions received	143,500	8,505
Net assets released from restriction	(68,852)	(8,500)
Increase in temporarily restricted net assets	74,648	5
Change in Net Assets	959,629	1,991,330
Net Assets, Beginning of Year	7,034,547	5,043,217
Net Assets, End of Year	\$ 7,994,176	\$ 7,034,547

Mendocino Community Health Clinic, Inc.
Statements of Cash Flows
Years Ended June 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Operating Activities		
Change in net assets	\$ 959,629	\$ 1,991,330
Items not requiring (providing) cash		
(Gain) loss on sale of property and equipment	70,681	(15,200)
Depreciation and amortization	956,441	881,220
Accrued litigation payable	-	50,000
Grants for acquisition of property and equipment	(998,459)	(2,466,131)
Changes in		
Patient accounts receivable, net	(419,679)	(31,672)
Grants receivable	11,938	426,521
Estimated amounts due from and to third-party payers	(10,000)	660,000
Prepaid assets and other assets	(144,182)	154,369
Inventory and supplies	(5,643)	(8,040)
Accounts payable and accrued expenses	161,633	148,507
	<u>582,359</u>	<u>1,790,904</u>
Investing Activities		
Purchase of assets limited as to use	-	(118)
Proceeds from disposition of assets limited as to use	6,607	-
Purchase of property and equipment	(1,475,652)	(2,458,984)
Proceeds from sale of property and equipment	2,400	15,200
	<u>(1,466,645)</u>	<u>(2,443,902)</u>
Financing Activities		
Proceeds from grants for acquisition of property and equipment	1,146,723	2,297,867
Principal payments on long-term debt	(532,428)	(656,048)
Principal payments on notes payable to bank	-	(350,000)
	<u>614,295</u>	<u>1,291,819</u>
Increase (Decrease) in Cash and Cash Equivalents	(269,991)	638,821
Cash and Cash Equivalents, Beginning of Year	<u>1,225,013</u>	<u>586,192</u>
Cash and Cash Equivalents, End of Year	<u>\$ 955,022</u>	<u>\$ 1,225,013</u>
Supplemental Cash Flows Information		
Interest paid	\$ 197,052	\$ 205,043
Accounts payable incurred for property and equipment	\$ 23,256	\$ 173,489
Litigation payable financed with long-term debt	\$ -	\$ 50,000

Mendocino Community Health Clinic, Inc.
Notes to Financial Statements
June 30, 2014 and 2013

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 and Cash Equivalents

The Organization considers all liquid investments, other than those limited as to use, with original maturities of three months or less to be cash equivalents. At June 30, 2014 and 2013, cash equivalents consisted primarily of money market deposit accounts.

At June 30, 2014, the Organization’s cash accounts exceeded federally insured limits by approximately \$950,000.

Investment Return

Investment return is comprised of interest income and is reported in the statement of operations as a component of unrestricted net assets.

Assets Limited as to Use

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

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.

Mendocino Community Health Clinic, Inc.

Notes to Financial Statements

June 30, 2014 and 2013

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 decreased from 95% of self-pay accounts receivable at June 30, 2013, to 92% of self-pay accounts receivable at June 30, 2014. In addition, the Organization's write-offs decreased approximately \$306,000 from approximately \$196,000 for the year ended June 30, 2013, to approximately \$(110,000) for the year ended June 30, 2014.

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.

The estimated useful lives for each major depreciable classification of property and equipment are as follows:

Land improvements	8-25 years
Buildings and leasehold improvements	5-40 years
Equipment	3-10 years

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.

Mendocino Community Health Clinic, Inc.

Notes to Financial Statements

June 30, 2014 and 2013

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, 2014 and 2013.

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.

340B Revenue

The Organization participates in the 340B “Drug Discount Program” which enables qualifying health care providers to purchase drugs from pharmaceutical suppliers at a substantial discount. The 340B Drug Pricing Program is managed by the Health Resources and Services Administration (HRSA) Office of Pharmacy Affairs. The Organization earns revenue under this program by purchasing pharmaceuticals at a reduced cost to fill prescriptions to qualified patients. The Organization has a network of participating pharmacies that dispense the pharmaceuticals to its patients under contract arrangement with the Organization. Reported 340B revenue consists of the pharmacy reimbursements, net of the initial purchase price of the drugs.

Mendocino Community Health Clinic, Inc.

Notes to Financial Statements

June 30, 2014 and 2013

The 340B gross receipts of \$1,386,999 and \$1,059,256, respectively, were recognized during the years ended June 30, 2014 and 2013, and are included in net patient service revenue on the statement of operations. The drug replenishment costs and administrative and filling fees and included in contract pharmacy expense on the statement of operations. The net 340B revenue from this program is used in furtherance of the Organization's mission.

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.

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.

Mendocino Community Health Clinic, Inc.

Notes to Financial Statements

June 30, 2014 and 2013

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

In 2014 and 2013, the Organization recorded revenue of \$148,750 and \$488,750, respectively, which is included in other revenue in the statements of operations.

Income Taxes

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

Deficiency of Revenues Over Expenses

The statements of operations include deficiency of revenues over expenses. Changes in unrestricted net assets which are excluded from deficiency of revenues over expenses, consistent with industry practice, include contributions and grants of long-lived assets (including assets acquired using contributions or grants which by donor or granting agency restriction were to be used for the purpose of acquiring such assets).

Subsequent Events

Subsequent events have been evaluated through the date of the Independent Auditor's 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, 2014 and 2013, the Organization received \$3,231,819 and \$3,016,250 in CHC grant funds, respectively. Funding for the grant year ending December 31, 2014, is approved at \$3,708,912. Funding for the grant year ending December 31, 2015, is approved at \$3,441,904.

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, 2014 and 2013, the Organization received \$438,810 and \$477,692 in grant funds, respectively. Funding for the grant year ending December 31, 2014, is approved at \$452,299.

Mendocino Community Health Clinic, Inc.

Notes to Financial Statements

June 30, 2014 and 2013

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, 2014 and 2013, the Organization recognized \$962,459 and \$2,466,131, 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.

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.

Mendocino Community Health Clinic, Inc.

Notes to Financial Statements

June 30, 2014 and 2013

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, 2014, 2013, 2012 and 2011. Such amounts are recorded on the balance sheets as estimated amounts due from third-party payers.

The 2014 net patient service revenue did not include any material change in estimates related to changes in estimates related to the annual Medi-Cal Reconciliation Request Forms for dates of service prior to July 1, 2013.

The 2013 net patient service revenue decreased by approximately \$155,000 due to changes in estimates related to annual Medi-Cal Reconciliation Request Forms for dates of service prior to July 1, 2012.

Laws and regulations governing the Medicare and Medi-Cal 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, 2014 and 2013, was approximately:

	2014	2013
Medicare	\$ 4,287,363	\$ 4,388,223
Medi-Cal	12,973,157	9,813,426
Other third-party payers	4,364,147	4,736,801
Self-pay	1,311,864	1,661,167
	<u>\$ 22,936,531</u>	<u>\$ 20,599,617</u>

Mendocino Community Health Clinic, Inc.

Notes to Financial Statements

June 30, 2014 and 2013

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, 2014 and 2013, was:

	<u>2014</u>	<u>2013</u>
Medicare	9%	13%
Medi-Cal	76%	66%
Other third-party payers	4%	3%
Self-pay	11%	18%
	<u>100%</u>	<u>100%</u>

Note 5: 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.

Claim liabilities are determined without consideration of insurance recoveries. Expected recoveries are presented separately. Based upon the Organization's claim experience, no accrual has been made for the Organization's medical malpractice cost for the years ended June 30, 2014 and 2013. 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 6: Temporarily Restricted Net Assets

Temporarily restricted net assets are available for the following purpose:

	<u>2014</u>	<u>2013</u>
Health care services	<u>\$ 75,000</u>	<u>\$ 352</u>

During 2014 and 2013, net assets were released from donor restrictions by incurring expenses, satisfying the restricted purposes in the amount of \$68,852 and \$8,500, respectively.

Mendocino Community Health Clinic, Inc.

Notes to Financial Statements

June 30, 2014 and 2013

Note 7: Note Payable to Bank

The Organization has a \$1,500,000 revolving bank line of credit expiring on June 2, 2015. The Organization had no borrowings against the line at June 30, 2014 and 2013, respectively. The line is collateralized by substantially all of the Organization's assets. Interest varies with the bank's prime rate, which was 3.25% at June 30, 2014, and is payable monthly.

Note 8: Long-Term Debt

	2014	2013
United States Department of Agriculture, Hillside (A)	\$ 1,426,813	\$ 1,476,962
United States Department of Agriculture, Lakeside (B)	765,219	800,971
United States Department of Agriculture, Little Lake (C)	647,361	667,339
Rural Community Assistance Corporation (D)	707,250	721,509
California Department of Health Services, Hillside (E)	365,920	421,754
California Department of Health Services, Lakeside (F)	161,806	191,920
California Department of Health Services, Little Lake (G)	121,543	143,579
County Medical Services Program (H)	-	304,306
	4,195,912	4,728,340
Less current maturities	236,163	436,399
	\$ 3,959,749	\$ 4,291,941

- (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 2029; 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.

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.

Mendocino Community Health Clinic, Inc.
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- (C) Due May 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 August 2020; payable \$5,278 monthly including interest at 1.995%; secured by Medi-Cal billings.
- (F) Due July 2019; payable \$2,785 monthly including interest at 1.859%; secured by Medi-Cal billings.
- (G) Due September 2019; payable \$2,058 monthly including interest at 1.995%; secured by Medi-Cal billings.
- (H) Due July 2014; payable \$26,042 monthly through February 2014 and \$95,975 in July 2014; secured by CMSP billings. The Community Medical Services Program loan was incurred as final settlement of a historical claims settlement. See *Note 12* for settlement of litigation. During 2014, note was paid in full.

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 at June 30, 2014, are:

2015	\$ 236,163
2016	244,446
2017	253,583
2018	262,628
2019	272,240
Thereafter	<u>2,926,852</u>
	<u><u>\$ 4,195,912</u></u>

Mendocino Community Health Clinic, Inc.

Notes to Financial Statements

June 30, 2014 and 2013

Note 9: Functional Expenses

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

	<u>2014</u>	<u>2013</u>
Health care services	\$ 19,546,219	\$ 18,288,522
General and administrative	<u>7,685,964</u>	<u>7,060,291</u>
	<u>\$ 27,232,183</u>	<u>\$ 25,348,813</u>

Note 10: 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 2014 and 2013.

Note 11: Construction in Progress

At June 30, 2014, the Organization had several projects outstanding, including renovations at the all three location with costs of approximately \$110,000 incurred through year end. The expected costs to complete these projects are approximately \$25,000. All renovation projects are expected to be completed by March 2015.

The Organization also had a phone system project in construction in progress at year end with approximately \$55,000 in costs incurred as of June 30, 2014. The expected costs to complete this ongoing project are unknown. This project is expected to be completed by September 2015.

The Organization financed these projects using internally generated funds.

Note 12: 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:

Mendocino Community Health Clinic, Inc.
Notes to Financial Statements
June 30, 2014 and 2013

Grant Awards

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

Allowance for Net Patient Service Revenue Adjustments

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

Malpractice Claims

Estimates related to the accrual for medical malpractice claims are described in *Note 5*.

Litigation

In the normal course of business, the Organization is, from time to time, subject to allegations that may or do result in litigation. The Organization evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of counsel, management records an estimate of the amount of ultimate expected loss, if any, for each of these matters. Events could occur that would cause the estimate of loss to differ materially in the near term.

Current Economic Conditions

The current economic environment continues to present community health centers with difficult circumstances and challenges, which in some cases have resulted in 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 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.

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 to allowances for accounts that could negatively impact the Organization's ability to maintain sufficient liquidity.

Supplementary Information

Mendocino Community Health Clinic, Inc.
Schedule of Expenditures of Federal Awards
Year Ended June 30, 2014

Cluster/Program	Federal Agency/ Pass-Through Entity	CFDA Number	Grant or Identifying Number	Amount Expended
Consolidated Health Centers	U.S. Department of Health and Human Services	93.224	6 H80 CS 00628-13-03	\$ 1,552,306
Affordable Care Act Grants for New and Expanded Services Under the Health Center Program	U.S. Department of Health and Human Services	93.527	6 H80 CS 00628-13-03	<u>1,679,513</u>
Total Health Center Cluster				3,231,819
Grants to Provide Outpatient Early Intervention Services with Respect to HIV Disease	U.S. Department of Health and Human Services	93.918	6 H76HA 00170-19-02	438,809
Affordable Care Act Capital Development Grants	U.S. Department of Health and Human Services	93.526	4 C8A CS 21248-01-04	962,459
Grants to States to Support Oral Health Workforce Activities	U.S. Department of Health and Human Services / University of the Pacific	93.236	T12HP19362	31,239
Community Facilities Loans and Grants	U.S. Department of Agriculture	10.766		<u>36,000</u>
				<u><u>\$ 4,700,326</u></u>

Mendocino Community Health Clinic, Inc.
Schedule of Expenditures of Federal Awards
Year Ended June 30, 2014

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. Of the federal expenditures presented in this schedule, Mendocino Community Health Clinic, Inc. provided federal awards to subrecipients as follows:

Program	CFDA Number	Subrecipient	Amount Provided
Grants to Provide Outpatient Early Intervention Services with Respect to HIV Disease	93.918	Mendocino Coast Clinic	\$ 65,353

Independent Auditor's 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, 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, the financial statements of Mendocino Community Health Clinic, Inc., which comprise the balance sheet as of June 30, 2014, and the related statements of operations, changes in net assets and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated February 20, 2015.

Internal Control over Financial Reporting

Management of the Organization is responsible for establishing and maintaining effective internal control over financial reporting (internal control). In planning and performing our audit, we considered the Organization's internal control to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of the Organization's internal control.

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

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

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*.

We noted certain matters that we reported to the Organization's management in a separate letter dated February 20, 2015.

Purpose of this Report

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

BKD, LLP

Springfield, Missouri
February 20, 2015

Report on Compliance with Requirements for Each Major Federal Program and Report on Internal Control over Compliance

Independent Auditor's Report

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

Report on Compliance for Each Major Federal Program

We have audited the compliance of Mendocino Community Health Clinic, Inc. 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 its major federal programs for the year ended June 30, 2014. The Organization's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

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

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of Mendocino Community Health Clinic, Inc.'s major federal programs based on our audit of the types of compliance requirements referred to above.

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

Opinion on Each Major Federal Program

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

Board of Directors
Mendocino Community Health Clinic, Inc.

Report on Internal Control Over Compliance

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

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

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

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

BKD, LLP

Springfield, Missouri
February 20, 2015

Mendocino Community Health Clinic, Inc.
Schedule of Findings and Questioned Costs
Year Ended June 30, 2014

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, 2014

Findings Required to be Reported by *Government Auditing Standards*

Reference Number	Finding	Questioned Costs
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No matters are reportable.

Mendocino Community Health Clinic, Inc.
Schedule of Findings and Questioned Costs
Year Ended June 30, 2014

Findings Required to be Reported by OMB Circular A-133

Reference Number	Finding	Questioned Costs
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No matters are reportable.

Mendocino Community Health Clinic, Inc.
Summary Schedule of Prior Audit Findings
Year Ended June 30, 2014

Reference Number	Finding	Status
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No matters are reportable.