

**North County Health Project, Inc.  
d/b/a North County Health Services  
Consolidated Financial Statements**

**December 31, 2012 and 2011  
(With Independent Auditors' Report Thereon)**

**North County Health Project, Inc.**  
**d/b/a North County Health Services**  
**December 31, 2012 and 2011**

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# TCA Partners, LLP

A Certified Public Accountancy Limited Liability Partnership

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## ***Independent Auditors' Report on Financial Statements and Supplementary Schedule of Expenditures of Federal Awards***

Board of Directors  
North County Health Project, Inc.  
d/b/a North County Health Services  
San Marcos, California

### **Report on the Financial Statements**

We have audited the accompanying financial statements of North County Project, Inc., d/b/a North County Health Services (the "Center"), which comprise the balance sheets as of December 31, 2012 and 2011 and the related statements of operations and 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 the accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

#### ***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 of 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 North County Project, Inc., d/b/a North County Health Services as of December 31, 2012 and 2011 and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

**Report on Other Legal and Regulatory Requirements**

In accordance with Government Auditing Standards, we have also issued our report dated April 12, 2013, on our consideration of the entity's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. 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 read in conjunction with this report in considering the results of our audit.

Our audit was performed for the purpose of forming an opinion on the basic financial statements of the Center taken as a whole. The accompanying Schedule of Expenditures of Federal Awards is presented for the purpose of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

***TCA Partners, LLP***

Fresno, California

April 12, 2013

**North County Health Project, Inc.**  
**d/b/a North County Health Services**  
**Consolidated Balance Sheets**  
**December 31, 2012 and 2011**

	<b>2012</b>	<b>2011</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 10,714,947	\$ 8,837,233
Patient accounts receivable, net of allowance;	2,492,425	1,824,571
Grant receivable	897,512	921,736
Contributions receivable	20,967	105,877
Estimated amounts due from third-party payers	5,394,116	3,188,603
Other receivables	638,859	1,119,890
Inventories	269,867	321,749
Prepaid expenses and other current assets	321,835	244,845
Total current assets	20,750,528	16,564,504
Assets limited as to use:		
Held by trustee	416,780	416,780
Deferred compensation	1,026,112	777,462
	1,442,892	1,194,242
Property and equipment, at cost:		
Land and land improvements	5,036,550	5,036,550
Buildings and leasehold improvements	19,327,163	18,264,731
Equipment	6,283,629	6,254,380
Construction in progress	963,927	284,363
	31,611,269	29,840,024
Less accumulated depreciation	(11,987,031)	(10,421,707)
	19,624,238	19,418,317
Other assets:		
Prepaid expenses and other long-term assets	954,764	1,001,343
Total assets	\$ 42,772,422	\$ 38,178,406

*See Notes to Financial Statements*

**North County Health Project, Inc.  
d/b/a North County Health Services  
Consolidated Balance Sheets  
December 31, 2012 and 2011**

	<b>2012</b>	<b>2011</b>
<b>Liabilities</b>		
Current liabilities		
Current maturities of long-term liabilities	\$ 272,802	\$ 260,826
Accounts payable	1,341,995	1,328,566
Accrued expenses	2,885,763	2,879,159
Deferred grant revenue	147,593	199,505
Total current liabilities	4,648,153	4,668,056
Deferred compensation	1,026,112	777,462
Long-term liabilities	11,963,153	11,133,968
Total liabilities	17,637,418	16,579,486
<b>Net Assets</b>		
Unrestricted	25,135,004	21,598,920
Total net assets	25,135,004	21,598,920
Total liabilities and net assets	\$ 42,772,422	\$ 38,178,406

*See Notes to Financial Statements*

**North County Health Project, Inc.  
d/b/a North County Health Services  
Consolidated Statements of Operations  
Years Ended December 31, 2012 and 2011**

	<b>2012</b>	<b>2011</b>
<b>Change in Unrestricted Net Assets:</b>		
Unrestricted revenues, gains and other support:		
Net patient service revenue	\$ 35,446,117	\$ 30,374,204
Grant revenue	10,527,291	10,941,835
Contributions	652,243	661,474
Other	1,077,452	1,375,579
Total unrestricted revenues, gains and other support	47,703,103	43,353,092
Expenses and losses:		
Salaries and wages	24,918,220	24,603,784
Employee benefits	5,017,600	4,660,491
Purchased services and professional fees	2,683,566	2,616,888
Supplies and other	6,181,057	6,291,085
Contractual services	2,383,601	2,354,224
Rent	369,815	373,654
Insurance	179,746	198,496
Client assistance	157,549	160,683
Depreciation	1,900,324	1,878,672
Interest	628,644	587,118
Total expenses	44,420,122	43,725,095
Excess revenues over expenses	3,282,981	(372,003)
Grants for acquisition of property and equipment	292,977	635,866
Loss of disposal of property and equipment	(39,874)	-
Change in unrestricted net assets	3,536,084	263,863
<b>Net Assets:</b>		
Beginning of year	21,598,920	21,335,057
End of year	\$ 25,135,004	\$ 21,598,920

*See Notes to Financial Statements*

**North County Health Project, Inc.**  
**d/b/a North County Health Services**  
**Consolidated Statements of Cash Flows**  
**Years Ended December 31, 2012 and 2011**

<b>Cash Flows from Operating Activities</b>	<u><b>2012</b></u>	<u><b>2011</b></u>
Change in net assets	\$ 3,536,084	\$ 263,863
Adjustments to reconcile operating income in net assets to net cash provided by operating activities:		
Loss on disposal of property and equipment	39,874	-
Depreciation and amortization	1,900,324	1,878,672
Grants for the acquisition of property and equipment	(292,977)	(635,866)
Amortization of refundable loan	(28,012)	-
Changes in operating assets and liabilities:		
Patient accounts receivable, net	(667,854)	620,417
Grants receivable	24,224	387,413
Contributions receivable	84,910	45,487
Estimated amounts due from and to third-party payers	(2,205,513)	(1,594,856)
Prepaid and other	502,502	(844,483)
Accounts payable and accrued expenses	20,033	807,578
Deferred revenue	(51,912)	(34,409)
Net cash provided by operating activities	<u>2,861,683</u>	<u>893,816</u>
 <b>Cash Flows from Investing Activities</b>		
Net change in assets limited as to use	-	3,501,290
Purchase of property and equipment	(2,146,119)	(1,677,836)
Net cash provided by (used in) investing activities	<u>(2,146,119)</u>	<u>1,823,454</u>
 <b>Cash Flows from Financing Activities</b>		
Proceeds from grants for acquisition of property and equipment	292,977	635,866
Proceeds from issuance of long-term debt	1,130,000	-
Principal payments on long-term debt	(260,827)	(3,685,206)
Net cash provided by (used in) financing activities	<u>1,162,150</u>	<u>(3,049,340)</u>
 Increase (decrease) in cash and cash equivalents	<u>1,877,714</u>	<u>(332,070)</u>
 <b>Cash and Cash Equivalents:</b>		
Beginning of year	<u>8,837,233</u>	<u>9,169,303</u>
End of year	<u>\$ 10,714,947</u>	<u>\$ 8,837,233</u>
 <b>Supplemental disclosure of cash flow information:</b>		
Interest paid	<u>\$ 582,081</u>	<u>\$ 587,118</u>

*See Notes to Financial Statements*

**North County Health Project, Inc.**  
**d/b/a North County Health Services**  
**Consolidated Notes to Financial Statements**  
**December 31, 2012 and 2011**

**Note 1: Summary of Significant Accounting Policies**

***Organization and Operations***

North County Health Project, Inc., d/b/a North County Health Services (the “Center”), is a federally qualified health center that works to further its mission to “improve the health status of our diverse communities by providing quality health care that is comprehensive, affordable and culturally sensitive.” The Center primarily earns revenues by providing medical, dental and mental health services through clinics located in Carlsbad, Encinitas, Oceanside, Ramona and San Marcos, California. In October 2008 the Center formed a new 501(c) (3) California nonprofit public benefit corporations named NCHS-Loma Alta. The purpose of the new corporation is to support the charitable purpose and activities of the Center, including the holding of New Market Tax Credit Loan.

The Center derives its support through grants and contracts with the U.S. Department of Health and Human Services (“DHHS”), US Department of Agriculture (“USDA”), the State of California, the County of San Diego, and various other entities. Additionally, revenues are derived from patient fees and third party charges.

***Cash and Cash Equivalents***

The Center considers all liquid investments, other than those limited as to use, with original maturities of three months or less to be cash equivalents. At December 31, 2012 and 2011, cash equivalents consisted primarily of money market accounts. Of the cash balances as of December 31, 2012 and 2011, \$7,037,833 and \$6,050,995 respectively was covered by federal depository insurance and \$3,677,114 and \$2,786,238, respectively, was uninsured.

***Patient Accounts Receivable***

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

***Third-Party Contractual Agreements***

The Center has agreements with Medicare that provide payments under a cost-based reimbursement system and with Medi-Cal that provide payments under the Prospective Payment System (“PPS”). In the case of Medicare, reasonable estimates are made and reported in the period services are rendered, and differences between the estimates and actual receipts are included in the statement of operations in the period in which they are determined. In the case of Medi-Cal, payments under the PPS system are final, unless the number of reimbursable visits is changed as a result of an audit by the State of California, Department of Healthcare Services. In addition, under the Medi-Cal PPS, the Center may apply for a change-in-scope of services annually. This process may result in additional Medi-Cal reimbursement for the Center.

**North County Health Project, Inc.**  
**d/b/a North County Health Services**  
**Consolidated Notes to Financial Statements**  
**December 31, 2012 and 2011**

**Note 1: Summary of Significant Accounting Policies (Continued)**

***Inventories***

Inventories consist of pharmaceutical, medical and office supplies and are stated at cost. Due to rapid turnover of supplies, cost approximates market value.

***Assets Limited As to Use***

Assets limited as to use include cash held by trustee related to Center debt agreements, and assets set aside for deferred retirement benefits.

***Property and Equipment***

Land, building and equipment are carried at cost or estimated fair value at date of acquisition. The Center capitalizes all acquisitions greater than \$5,000 and such assets are depreciated on a straight-line basis over the estimated useful life of each asset. 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 various federal agencies. Such items, or a portion thereof, 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 market value as an increase in unrestricted net assets unless the donor restricts use of the assets. 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. Donor restricted contributions for property and equipment whose restrictions are met within the same year as received are reported as unrestricted contributions. Construction-in-progress is recorded at cost and is capitalized upon completion. Depreciation is recorded when construction is substantially complete and the assets are placed in service.

***Use of Estimates***

The preparation of consolidated 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 consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

***Investment Return***

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

***Temporarily and Permanently Restricted Net Assets***

Contributions, including government grants and contracts, are recorded as either temporarily or permanently restricted revenue if they are received with donor stipulations that limit the use of the donated asset. When a donor restriction expires, that is, when a stipulated time restrictions ends or purpose restriction is accomplished, temporarily restricted assets are reclassified to unrestricted net assets and reported in the statement of operations and changes in net assets as net assets released from restrictions. Donor-restricted contributions whose restrictions expire during the same fiscal year are recognized as unrestricted revenue.

**North County Health Project, Inc.**  
**d/b/a North County Health Services**  
**Consolidated Notes to Financial Statements**  
**December 31, 2012 and 2011**

**Note 1: Summary of Significant Accounting Policies (Continued)**

***Income Taxes***

The Center has been recognized as exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code and Section 23701(d) of the State of California Revenue and taxation Code by the IRS and Franchise Tax Board, respectively. Accordingly, no provision for income taxes is included in the accompanying financial statements.

***Net Patient Service Revenue***

The Center has agreements with third-party payers that provide for payments to the Center 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, including estimated retroactive adjustments. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such estimated amounts are revised in future periods as adjustments become known.

***Contributions***

Unconditional promises to give cash and other assets are accrued at estimated fair value at the date each promise is received. 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.

***Donated Supplies***

The Center recognizes donated pharmaceuticals at fair value. Donated pharmaceuticals totaling \$420,783 and \$435,381 are recorded as contribution revenue and supplies and other expense for the years ended December 31, 2012 and 2011, respectively.

***Excess of Revenues Over Expenses***

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

***Reclassification***

Certain reclassifications have been made to the 2011 financial statements to conform to the 2012 financial statement presentation. These reclassifications had no effect on the changes in net assets.

**North County Health Project, Inc.**  
**d/b/a North County Health Services**  
**Consolidated Notes to Financial Statements**  
**December 31, 2012 and 2011**

**Note 2: Fair Value of Financial Instruments**

Financial Accounting Standards Board's (FASB) Accounting Standard Codification (ASC) 820, *Fair Value Measurements and Disclosures*, requires the fair value of financial assets and liabilities to be determined using a specific fair-value hierarchy. The objective of the fair value measurement of financial instruments is to reflect the hypothetical amounts at which the Center could sell assets or transfer liabilities in an orderly transaction between market participants at the measurement date. FASB ASC 820 describes three levels of inputs that may be used to measure fair value:

**Level 1** - Quoted prices in active markets for identical assets;

**Level 2** - Observable inputs other than Level I prices, such as quoted prices for similar assets; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets;

**Level 3** - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets.

Pursuant to FASB ASC 820, the Center's investments are classified within Level 1 of the fair-value hierarchy. The types of securities valued based on Level 1 inputs include money market securities. The following table presents the fair value measurements of assets recognized in the accompanying balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at December 31, 2012:

	Fair Value	Fair Value Measurement Using		
		Level 1	Level 2	Level 3
December 31, 2012:				
Money market funds	\$ 1,874,201	\$ 1,874,201	\$ -	\$ -
Stocks	25,799	25,799	-	-
<b>Total</b>	<b>\$ 1,900,000</b>	<b>\$ 1,900,000</b>	<b>\$ -</b>	<b>\$ -</b>
December 31, 2011:				
Money market funds	\$ 2,724,192	\$ 2,724,192	\$ -	\$ -
<b>Total</b>	<b>\$ 2,724,192</b>	<b>\$ 2,724,192</b>	<b>\$ -</b>	<b>\$ -</b>

The carrying amounts reported in the balance sheets for other financial assets and liabilities that are not measured at fair value on a recurring basis including patient accounts receivable, grant and other receivables, settlement receivables, accounts payable, accrued payroll and other expenses, deferred revenue, long term debt, and estimated third party liabilities approximate fair value.

**North County Health Project, Inc.**  
**d/b/a North County Health Services**  
**Consolidated Notes to Financial Statements**  
**December 31, 2012 and 2011**

**Note 3: Grant Revenue**

The Center is the recipient of a couple of Consolidated Health Center (CHC) grants from the U.S. Department of Health and Human Services. The general purpose of the grants is to provide expanded health care service delivery for residents of northern San Diego County, California. Terms of the grants generally provide for funding of the Center's operations based on an approved budget. During the years ended December 31, 2012 and 2011, the Center recognized \$5,262,098 and \$5,109,813 in CHC grant revenue, respectively. Grant revenue is recognized as qualifying expenditures are incurred over the grant period.

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

**Note 4: Net Patient Service Revenue**

The Center is approved as a Federally Qualified Health Center (FQHC) for both Medicare and Medi-Cal reimbursement purposes. The Center has agreements with third-party payers that provide for payments to the Center 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 Center is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of an annual cost report by the Center 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 based on a prospective reimbursement methodology. The Center is reimbursed a set encounter rate for all services provided under the plan. Services not covered under the FQHC benefit are paid based on established fee schedules.

Approximately 77% and 71% of net patient service revenues are from participation in the Medicare and state-sponsored Medi-Cal programs for the years ended December 31, 2012 and 2011, respectively. 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 Center has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the Center under these agreements includes prospectively determined rates and discounts from established charges. The Center also has agreements for capitated patients for which North County Health Services receives a fixed amount per month per member to take care of member's primary and specialty medical care.

**North County Health Project, Inc.**  
**d/b/a North County Health Services**  
**Consolidated Notes to Financial Statements**  
**December 31, 2012 and 2011**

**Note 5: Concentrations of Credit Risk**

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

	<u>2012</u>	<u>2011</u>
Medicare	2%	2%
Medi-Cal	76%	51%
Other third-party payers	17%	43%
Private Pay	5%	4%
	<u>100%</u>	<u>100%</u>

**Note 6: Deferred Grant Revenue**

Deferred grant revenue consist of the following at December 31, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Tides Foundation	\$ 19,135	\$ -
Blue Shield of California Foundation	10,518	30,000
McChesney Foundation	25,504	83,347
Leichtag Foundation	50,000	-
Other	42,436	86,158
	<u>\$ 147,593</u>	<u>\$ 199,505</u>

**Note 7: Line-of-Credit**

The Center has a \$2,000,000 line-of-credit; expiring January 1, 2016. The line of credit is collateralized by receivables. At December 31, 2012 and 2011, there was no balance outstanding on the line-of-credit.

**North County Health Project, Inc.**  
**d/b/a North County Health Services**  
**Consolidated Notes to Financial Statements**  
**December 31, 2012 and 2011**

**Note 8: Long-Term Debt**

	2012	2011
On February 5, 2010 NCHS-Loma Alta entered into a New Market Tax Credit loan agreement through Impact V CDE3 LLC/NCB-Capital Impact. The agreement consists of three loans in the amounts of \$4,483,500, \$1,891,500 and \$750,000 for a total of \$7,125,000. All three promissory notes bear an annual interest rate of 5.546% and mature on February 4, 2016 at which time the principal balance of \$7,125,000 is due in full. The three notes are secured by the Oceanside real property.	7,125,000	7,125,000
The Center entered into a loan agreement with City National Bank on December 1, 2011 in the amount of \$4,500,000. These funds were used to refinance existing debt in January 2011 and to purchase property that was formerly being leased. This agreement consists of two loans in the amounts of \$3,500,000 and \$1,000,000. Series A loan is in the amount of \$3,500,000 and bears an interest rate of 4.32% with a maturity date of January 1, 2026. The Series B loan in the amount of \$1,000,000 and bears an interest rate of 4.1% with a maturity date of January 1, 2021. Collateral for these loans include real property.	4,008,968	4,269,794
The Center entered into a loan agreement with the City of Carlsbad on February 15, 2012 in the amount of \$1,130,000. These funds were allocated from a Community Block Development Grant (CDBG) as a no interest, deferred, and forgivable loan to be used for the acquisition of property for a health center to serve low income households. The loan has a term of 20 years and is forgivable upon the expiration of the term of the loan if the property has been maintained and operated as a health center consistent with the conditions of the loan.	1,101,987	-
Total long term debt	12,235,955	11,394,794
Less: current portion	(272,802)	(260,826)
	\$11,963,153	\$11,133,968

The interest expense paid in 2012 was \$628,643 and the aggregate annual maturities of long-term debt at December 31, 2012, are:

2013	\$ 272,802
2014	284,789
2015	297,300
2016	7,434,980
2017	323,981
Thereafter	3,622,103
	\$12,235,955

**North County Health Project, Inc.**  
**d/b/a North County Health Services**  
**Consolidated Notes to Financial Statements**  
**December 31, 2012 and 2011**

**Note 9: Commitments and Contingencies**

***Operating Leases***

Non-cancelable operating leases for the Center's facilities expire in various years through 2021. Future minimum lease payments are as follows: \$328,585 in 2013; \$322,285 in 2014; \$156,700 in 2015; \$40,292 in 2016; \$41,501 in 2017; and \$143,544 thereafter.

***Self-Insurance***

The Center was self-insured for employee worker's compensation insurance benefits prior to December 1, 2006 when the Center chose to purchase workers' compensation coverage for future claims.

The accrual for self-insurance is evaluated periodically throughout the fiscal year for adequacy based on staffing changes. The Center is liable for all workers' compensation claims up to \$250,000 that occurred through November 30, 2006. Individual claims that exceed the \$250,000 per claim self-insurance deductible are fully insured by a third-party insurance company. There is no aggregate deductible.

***Malpractice Claims***

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

***Pension Plan***

The Center has a 403(b) defined contribution pension plan covering substantially all employees who meet the eligibility requirements. The Center provides a discretionary match of eligible employee contributions to the plan up to 4% of employees' salaries. Pension expense related to the 403(b) defined contribution pension plan was \$550,434 and \$537,752 for the years ended December 31, 2012 and 2011, respectively.

The Center provides a 457(b) deferred compensation plan for certain executives. Under the terms of this plan, the deferred compensation liability and related assets limited as to use are recorded by the Center and are subject to the general creditors of the Center. Expense related to the 457(b) deferred compensation plan was \$288,052 and \$288,368 for the years ended December 31, 2012 and 2011, respectively.

***Forgivable Loan***

The Center entered into a loan agreement with the City of Carlsbad on February 15, 2012 in the amount of \$1,130,000. These funds were allocated from a Community Block Development Grant as a no interest, deferred, and forgivable loan to be used for the acquisition of property for a clinic to serve low income households. The loan has a term of 20 years and is forgivable upon the expiration of the term of the loan if the property has been maintained and operated as a clinic consistent with the conditions of the loan. The loan is being amortized over the life of the agreement, but in the case the Center does not maintain the clinic, the Center may be liable to refund the entire amount of the original loan to the City of Carlsbad.

**North County Health Project, Inc.**  
**d/b/a North County Health Services**  
**Consolidated Notes to Financial Statements**  
**December 31, 2012 and 2011**

**Note 10: Functional Expenses**

The Center provides healthcare services to residents within its service area. Expenses related to providing these services are as follows:

	<u>2012</u>	<u>2011</u>
Healthcare program services	\$36,871,840	\$33,483,979
General and administrative	7,370,843	5,621,157
Fundraising	217,312	202,420
	<u>\$44,459,995</u>	<u>\$39,307,556</u>

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## ***Independent Accountants' Report on Consolidating Schedules***

Board of Directors  
North County Health Project, Inc.  
d/b/a North County Health Services  
San Marcos, California

We have audited and reported separately herein on the consolidated financial statements of North County Project, Inc., d/b/a North County Health Services (the "Center") as of and for the year ended December 31, 2012.

Our audit was conducted for the purpose of forming an opinion on the financial statements of North County Project, Inc., d/b/a North County Health Services taken as a whole. The consolidating information include in page 17 through 19 is presented for purposes of additional analysis and is not a required part of the financial statements. The consolidating 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.

***TCA Partners, LLP***

Fresno, California

April 12, 2013

**North County Health Project, Inc.**  
**d/b/a North County Health Services**  
**Consolidating Schedule - Balance Sheets Information**  
**December 31, 2012**

	<b>NCHS</b>	<b>Loma Alta</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Assets</b>				
Current assets				
Cash and cash equivalents	\$ 10,519,318	\$ 195,629	\$ -	\$ 10,714,947
Patient accounts receivable, net of allowance	2,492,425	-	-	2,492,425
Grant receivable	897,512	-	-	897,512
Contributions receivable	20,967	-	-	20,967
Estimated amounts due from third-party payers	5,394,116	-	-	5,394,116
Other receivables	638,859	548,638	(548,638)	638,859
Inventories	269,867	-	-	269,867
Prepaid expenses and other current assets	238,947	82,888	-	321,835
Total current assets	20,472,011	827,155	(548,638)	20,750,528
Assets limited as to use				
Held by trustee	416,780	-	-	416,780
Deferred compensation	1,026,112	-	-	1,026,112
	1,442,892	-	-	1,442,892
Property and equipment, at cost				
Land and land improvements	5,036,550	-	-	5,036,550
Buildings and leasehold improvements	12,448,776	6,878,387	-	19,327,163
Equipment	6,283,629	-	-	6,283,629
Construction in progress	963,927	-	-	963,927
	24,732,882	6,878,387	-	31,611,269
Less accumulated depreciation	(10,501,019)	(1,486,012)	-	(11,987,031)
	14,231,863	5,392,375	-	19,624,238
Other assets				
Prepaid and other long-term assets	954,764	-	-	954,764
Total assets	\$ 37,101,530	\$ 6,219,530	\$ (548,638)	\$ 42,772,422

**North County Health Project, Inc.**  
**d/b/a North County Health Services**  
**Consolidating Schedule - Balance Sheets Information**  
**December 31, 2012**

	<b>NCHS</b>	<b>Loma Alta</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Liabilities and Net Assets</b>				
Current Liabilities				
Current maturities of long-term liabilities	\$ 272,802	\$ -	\$ -	\$ 272,802
Accounts payable	1,341,995	-	-	1,341,995
Accrued expenses	2,885,763	-	-	2,885,763
Other Payables	548,638	-	(548,638)	-
Deferred grant revenue	147,593	-	-	147,593
Total current liabilities	5,196,791	-	(548,638)	4,648,153
Deferred Compensation	1,026,112	-	-	1,026,112
Long-Term Liabilities	4,838,153	7,125,000	-	11,963,153
Total liabilities	11,061,056	7,125,000	(548,638)	17,637,418
<b>Net Assets</b>				
Unrestricted	26,040,474	(905,470)	-	25,135,004
Total net assets	26,040,474	(905,470)	-	25,135,004
Total liabilities and net assets	\$37,101,530	\$6,219,530	\$ (548,638)	\$ 42,772,422

**North County Health Project, Inc.**  
**d/b/a North County Health Services**  
**Consolidating Schedule – Statement of Operations and Changes in Net Assets Information**  
**December 31, 2012**

	<b>NCHS</b>	<b>Loma Alta</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Change in Unrestricted Net Assets</b>				
Unrestricted revenues, gains and other support:				
Net patient service revenue	\$ 35,446,117	\$ -	\$ -	\$ 35,446,117
Grant revenue	10,527,291	-	-	10,527,291
Contributions	652,243	-	-	652,243
Other	1,076,319	406,733	(405,600)	1,077,452
Total unrestricted revenues, and other support	<u>47,701,970</u>	<u>406,733</u>	<u>(405,600)</u>	<u>47,703,103</u>
Expenses and Losses:				
Salaries and wages	24,918,220	-	-	24,918,220
Employee benefits	5,017,600	-	-	5,017,600
Purchased services and professional fees	2,683,566	-	-	2,683,566
Supplies and other	6,181,057	-	-	6,181,057
Contractual services	2,383,601	-	-	2,383,601
Rent	775,415	-	(405,600)	369,815
Insurance	179,746	-	-	179,746
Client assistance	157,549	-	-	157,549
Depreciation	1,473,659	426,665	-	1,900,324
Interest	226,906	401,738	-	628,644
Total expenses	<u>43,997,319</u>	<u>828,403</u>	<u>(405,600)</u>	<u>44,420,122</u>
Excess revenues over expenses	3,704,651	(421,670)	-	3,282,981
Grants for acquisition of property and equipment	292,977	-	-	292,977
Loss on sale of property and equipment	(39,874)	-	-	(39,874)
Increase (decrease) in unrestricted net assets	<u>3,957,754</u>	<u>(421,670)</u>	<u>-</u>	<u>3,536,084</u>
Change in net assets	<u>3,957,754</u>	<u>(421,670)</u>	<u>-</u>	<u>3,536,084</u>
<b>Net assets:</b>				
Beginning of year	22,082,720	(483,800)	-	21,598,920
End of year	<u>\$ 26,040,474</u>	<u>\$ (905,470)</u>	<u>\$ -</u>	<u>\$ 25,135,004</u>

## **Supplementary Information**

**North County Health Project, Inc.  
d/b/a North County Health Services  
Schedule of Expenditures of Federal Awards  
Year Ended December 31, 2012**

<b>Grantor</b>	<b>Federal CFDA Number</b>	<b>Expenditures</b>
<b><u>U.S. Department of Health and Human Services:</u></b>		
<b>Direct:</b>		
Consolidated Health Centers -330 grant, CPSE, ESSP	*93.224	\$ 5,262,098
ARRA Capital Improvement Program (CIP)	*93.703	55,685
ACA Capital Development Grant (CDG)	*93.526	237,293
Ryan White Part C Outpatient EIS Program	*93.918	359,248
		5,914,324
<b>Pass through:</b>		
<b><u>Family Health Centers of San Diego</u></b>		
Consolidated Health Centers- Homeless Grant (HG)	*93.224	12,379
<b><u>County of San Diego</u></b>		
Expanded HIV Testing	93.943	90,552
HIV High Acuity Case Management	*93.917	318,112
Ryan White Part A- HIV Case Management	93.914	101,286
HIV Counseling and Testing Services	93.914	31,226
Ryan White Part A- Minority Aids Initiative	93.914	78,022
<b><u>California Family Health Council</u></b>		
Title X Family Planning	93.217	180,352
<b><u>Regents of University of California San Diego</u></b>		
Ryan White Part D	93.153	18,500
<b>Total U.S. Department of Health and Human Services</b>		6,744,753
<b><u>U.S. Department of Housing and Urban Development:</u></b>		
<b>Pass through:</b>		
<b><u>City of Carlsbad</u></b>		
Community Development Block Grants (CDBG)	14.218	1,802
<b><u>City of Oceanside</u></b>		
Community Development Block Grants (CDBG)	14.218	1,946
<b>Total U.S. Department of Housing and Urban Development</b>		3,748
<b><u>U.S. Department of Agriculture:</u></b>		
<b>Pass through:</b>		
<b><u>California Department of Health Care Services</u></b>		
WIC Peer Counseling Breastfeeding	10.556	186,226
WIC Regional Breastfeeding	*10.557	88,865
Supplemental Nutrition Program for Woman, Infants and Children	*10.557	1,977,130
<b>Total U.S. Department of Agriculture</b>		2,252,221
<b>Total Expenditures of Federal Awards</b>		\$ 9,000,722
*Major Programs		

**North County Health Project, Inc.  
d/b/a North County Health Services  
Notes to Schedule of Expenditures of Federal Awards  
Year Ended December 31, 2012**

**Note A: Basis of Presentation**

The accompanying Schedule of Expenditures of Federal Awards (the “Schedule”) summarizes the expenditures of North County Health Services (the “Center”) under programs of the federal government for the year ended December 31, 2012. Because the Schedule presents only a selected portion of the operations of the Center, it is not intended to, and does not, present the financial position, changes in net assets, or cash flows for the Center.

For purposes of the Schedule, federal awards include all grants and contracts entered into directly between the Center, agencies, and departments of the federal government. The awards are classified into major program categories in accordance with the provisions of Office of Management and Budget (OMB) Circular A-133, Audits of States, Local Government and Non-Profit Organizations.

**Note B: Basis of Accounting**

For purposes of the Schedule, expenditures for federal programs are recognized on the accrual basis of accounting. Expenditures are determined using the cost accounting principles and procedures set forth in OMB Circular A-122, Cost Principles for Non-Profit Organizations.

**Note C: Relationship of Schedule of Expenditures of Federal Awards to Financial Statements**

Consistent with management’s policy, federal awards are recorded in various revenue categories. As a result, the amount of total federal awards expended on the Schedule does not agree to total grant revenue on the Statement of Operations and Changes in Net Assets as presented in the Center’s Report on Audited Financial Statements.

**Note D: Pass-Through Awards**

North County Project, Inc., d/b/a North County Health Services provided federal awards to subrecipients as follows:

<b>Cluster/Program</b>	<b>Subrecipient</b>	<b>CFDA Number</b>	<b>Amount Expended</b>
Grants to provide Outpatient Early Intervention Services with Respect to HIV Disease	Vista Community Clinic	93.918	\$ 64,808
Grants to Provide Outpatient Early Intervention Services with Respect to HIV Disease	Neighborhood Health Center	93.918	81,693
			\$ 146,501

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

Board of Directors  
North County Health Project, Inc.  
d/b/a North County Health Services  
San Marcos, California

We have audited the financial statements of North County Project, Inc., d/b/a North County Health Services (the "Center") as of and for the year ended December 31, 2012, and have issued our report thereon dated April 12, 2013. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

### ***Internal Control Over Financial Reporting***

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

A control deficiency 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 misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Center's financial statements will not be prevented, or detected and corrected on a timely basis.

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

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

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

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

***TCA Partners, LLP***

Fresno, California

April 12, 2013

# TCA Partners, LLP

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## ***Independent Auditors' 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  
North County Health Project, Inc.  
d/b/a North County Health Services  
San Marcos, California

### ***Compliance***

We have audited the compliance of North County Health Project, Inc. d/b/a North County Health Services (the "Center") 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 each of its major federal programs for the year ended December 31, 2012. The Center's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Center's management. Our responsibility is to express an opinion on the Center's compliance based on our audit.

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

In our opinion, North County Health Project, Inc. d/b/a North County Health Services complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended December 31, 2012.

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

The management of North County Health Project, Inc. d/b/a North County Health Services is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Center's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Center's internal control over compliance.

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

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

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

***7CA Partners, LLP***

Fresno, California

April 12, 2013

**North County Health Project, Inc.  
d/b/a North County Health Services  
Schedule of Findings and Questioned Costs  
Year Ended December 31, 2012**

**I. Summary of Auditor's Results**

**Financial Statements**

Type of auditor's report issued Unqualified

Internal Control over financial reporting:  
Material weakness identified? \_\_\_ yes     X  no

Significant deficiency(ies) identified that are not  
considered to be material weaknesses? \_\_\_ yes     X  None Reported

Noncompliance material to the financial  
statements was disclosed by the audit? \_\_\_ yes     X  no

**Federal Awards**

Internal control over major programs:  
Material weakness identified? \_\_\_ yes     X  no

Significant deficiency(ies) identified that are not  
considered to be material weaknesses? \_\_\_ yes     X  None Reported

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

Any audit findings disclosed that are required to  
be reported by OMB Circular A-133. \_\_\_ yes     X  no

Identification of Major Program

<b>CFDA Number</b>	<b>Name of Federal Program or Cluster</b>
93.224	Community Health Centers
93.703	ARRA Capital Improvement Program
93.526	ACA Capital Development Grant
93.918	Ryan White Part C- Outpatient Early Intervention Services Program
93.224	Consolidated Health Centers- Homeless Grant
93.917	HIV High Acuity Case Management
10.557	WIC Regional Breastfeeding
10.557	Supplemental Nutrition Program for Woman, Infants and Children

Dollar threshold used to distinguish between  
Type A and B programs \$300,000

The Center qualified as a low-risk auditee  X  yes    \_\_\_ no

**North County Health Project, Inc.  
d/b/a North County Health Services  
Schedule of Findings and Questioned Costs  
Year Ended December 31, 2012**

**II Current Year Audit Findings and Questioned Costs**

**Financial Statement Findings:**

No matters are reportable.

**Federal Awards Findings and Questioned Costs:**

No matters are reportable.

**III Prior Year Audit Findings and Questioned Costs**

None Reported