

Community Health Association of Spokane, Inc.

Accountants' Reports and Financial Statements

October 31, 2012 and 2011

Community Health Association of Spokane, Inc.
October 31, 2012 and 2011

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

Board of Directors
Community Health Association of Spokane, Inc.
Spokane, Washington

We have audited the accompanying balance sheets of Community Health Association of Spokane, Inc. (the "Organization") as of October 31, 2012 and 2011, and the related statements of operations, changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Community Health Association of Spokane, Inc. as of October 31, 2012 and 2011, and the results of its operations, the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated May 14, 2013, on our consideration of the Organization's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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

BKD, LLP

May 14, 2013

Community Health Association of Spokane, Inc.

Balance Sheets

October 31, 2012 and 2011

Assets

	<u>2012</u>	<u>2011</u>
Current Assets		
Cash	\$ 4,273,245	\$ 6,055,987
Patient accounts receivable, net of allowance; 2012 - \$704,088, 2011 - \$761,798	1,812,084	1,739,465
Grants and other receivables	865,808	132,608
Estimated amounts due from third-party payers	65,114	40,000
Cost pool receivable	156,000	570,844
Supplies	321,522	275,777
Pharmacy inventory	292,697	337,453
Prepaid expenses and other	219,354	196,780
	<u>8,005,824</u>	<u>9,348,914</u>
Assets Limited As To Use		
Externally restricted by loan agreement	<u>1,585,513</u>	<u>1,585,513</u>
Property and Equipment, At Cost		
Land and land improvements	2,008,910	2,008,910
Buildings and leasehold improvements	11,705,383	8,873,847
Equipment	3,528,923	3,128,251
Furniture and fixtures	1,316,864	1,034,769
Construction in progress	569,811	406,848
	<u>19,129,891</u>	<u>15,452,625</u>
Less accumulated depreciation	<u>6,328,532</u>	<u>5,827,992</u>
	<u>12,801,359</u>	<u>9,624,633</u>
Deferred Financing Costs	<u>20,361</u>	<u>22,867</u>
Total assets	<u>\$ 22,413,057</u>	<u>\$ 20,581,927</u>

Liabilities and Net Assets

	<u>2012</u>	<u>2011</u>
Current Liabilities		
Current maturities of long-term debt	\$ 410,966	\$ 303,921
Accounts payable	1,295,805	1,116,405
Accrued expenses	1,294,671	1,229,820
Estimated amounts due to third-party payers	1,182,747	2,363,191
Estimated self-insurance costs	<u>275,000</u>	<u>190,000</u>
Total current liabilities	4,459,189	5,203,337
Accrued Rent Payable	103,911	79,342
Long-Term Debt	<u>4,476,883</u>	<u>4,653,162</u>
Total liabilities	<u>9,039,983</u>	<u>9,935,841</u>
Net Assets		
Unrestricted	<u>13,373,074</u>	<u>10,646,086</u>
Total net assets	<u>13,373,074</u>	<u>10,646,086</u>
Total liabilities and net assets	<u><u>\$ 22,413,057</u></u>	<u><u>\$ 20,581,927</u></u>

Community Health Association of Spokane, Inc.
Statements of Operations
Years Ended October 31, 2012 and 2011

	2012	2011 (Adjusted - Note 1)
Unrestricted Revenues, Gains and Other Support		
Patient service revenue (net of contractual discounts and allowances)	\$ 26,084,334	\$ 23,125,312
Provision for uncollectible accounts	(1,254,506)	(1,390,314)
Net patient service revenue less provision for uncollectible accounts	24,829,828	21,734,998
Premium revenue and cost pool savings	9,208,439	9,040,719
Grant revenue	4,075,569	4,069,653
Electronic health record incentive program revenue	654,500	1,041,250
Contribution revenue	106,650	75,528
Other	220,211	196,072
	39,095,197	36,158,220
Expenses and Losses		
Salaries and wages	20,155,933	18,503,866
Employee benefits	4,340,799	3,825,461
Purchased services and professional fees	2,048,682	2,046,737
Supplies and other	7,942,649	7,511,271
Rent	700,353	657,459
Depreciation and amortization	1,124,857	972,453
Interest	54,936	267,199
	36,368,209	33,784,446
	2,726,988	2,373,774
Operating Income and Excess of Revenues Over Expenses		
Grants for acquisition of property and equipment	-	496,602
	\$ 2,726,988	\$ 2,870,376
	\$ 2,726,988	\$ 2,870,376

Community Health Association of Spokane, Inc.
Statements of Changes in Net Assets
Years Ended October 31, 2012 and 2011

	2012	2011
Unrestricted Net Assets		
Excess of revenues over expenses	\$ 2,726,988	\$ 2,373,774
Grants for acquisition of property and equipment	-	496,602
Increase in unrestricted net assets	2,726,988	2,870,376
Change in Net Assets	2,726,988	2,870,376
Net Assets, Beginning of Year	10,646,086	7,775,710
Net Assets, End of Year	\$ 13,373,074	\$ 10,646,086

Community Health Association of Spokane, Inc.
Statements of Cash Flows
Years Ended October 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Operating Activities		
Change in net assets	\$ 2,726,988	\$ 2,870,376
Items not requiring (providing) operating cash		
Loss on disposal of property and equipment	24,641	-
Depreciation and amortization	1,124,857	972,453
Grants for acquisition of property and equipment	-	(496,602)
Accrued self-insurance costs	70,000	33,156
Changes in		
Patient accounts receivable, net	(72,619)	(176,406)
Grants receivable	(733,200)	268,425
Estimated amounts due from and to third-party payers	(1,205,558)	1,552,544
Cost pool receivable and liability	414,844	(696,080)
Prepaid expenses	(22,574)	143,741
Inventory and supplies	(989)	(100,325)
Accounts payable, accrued expenses and other	(58,112)	377,421
	<u>2,268,278</u>	<u>4,748,703</u>
Net cash provided by operating activities		
Investing Activities		
Acquisition of assets limited as to use	-	(1,585,513)
Purchase of property and equipment	(3,709,805)	(2,595,456)
	<u>(3,709,805)</u>	<u>(4,180,969)</u>
Net cash used in investing activities		
Financing Activities		
Proceeds from grants for acquisition of property and equipment	-	496,602
Proceeds from issuance of long-term debt	-	5,012,000
Principal payments on long-term debt	(341,215)	(1,961,584)
	<u>(341,215)</u>	<u>3,547,018</u>
Net cash provided by (used in) financing activities		
Increase (Decrease) in Cash	(1,782,742)	4,114,752
Cash, Beginning of Year	<u>6,055,987</u>	<u>1,941,235</u>
Cash, End of Year	<u>\$ 4,273,245</u>	<u>\$ 6,055,987</u>
Supplemental Cash Flows Information		
Interest paid (net of capitalized)	\$ 55,460	\$ 261,733
Acquisition of property and equipment included in accounts payable	\$ 624,844	\$ 282,912
Capital lease obligation incurred for property and equipment	\$ 271,981	\$ -

Community Health Association of Spokane, Inc.

Notes to Financial Statements

October 31, 2012 and 2011

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

Nature of Operations

Community Health Association of Spokane, Inc. (the “Organization”) is a federally qualified health center that primarily earns revenues by providing physician and related health and dental care services through clinics located in Spokane County, Deer Park and Clarkston, Washington, and Lewiston, Idaho. The Organization’s mission is to improve the overall health of the communities we serve by expanding access to quality health and wellness services.

Change in Accounting Principle

In 2012, the Organization changed its method of presentation and disclosure of patient service revenue, provision for uncollectible accounts and the allowance for doubtful accounts in accordance with Accounting Standards Update (ASU) 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts and the Allowance for Doubtful Accounts for Certain Health Care Entities*. The major changes associated with ASU 2011-07 are to reclassify the provision for uncollectible accounts related to patient service revenue to a deduction from patient service revenue and to provide enhanced disclosures around the Organization’s policies related to uncollectible accounts. The change had no effect on prior year change in net assets.

	As Previously Reported	Effect of Change
	As Adjusted	
Net patient service revenue less		
provision for uncollectible accounts	\$ 21,734,998	\$ 23,125,312
Total expenses and losses	33,784,446	(1,390,314)

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

Pursuant to legislation enacted in 2010, the FDIC fully insured all noninterest-bearing transaction accounts beginning December 31, 2010, through December 31, 2012, at all FDIC-insured institutions. This legislation expired on December 31, 2012. Beginning January 1, 2013, noninterest-bearing transaction accounts are subject to the \$250,000 limit on FDIC insurance per covered institution.

Community Health Association of Spokane, Inc.

Notes to Financial Statements

October 31, 2012 and 2011

At October 31, 2012, the Organization's cash accounts exceeded federally insured limits by approximately \$5,687,000.

Assets Limited as to Use

Assets limited as to use include cash restricted by a loan agreement for future capital improvements. 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 collectibility of accounts receivable, the Organization analyzes its past history and identifies trends for each of its major payer sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for uncollectible accounts. Management regularly reviews data about these major payer sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts.

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

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

The Organization's allowance for doubtful accounts for self-pay patients decreased to 83% from 86% of self-pay accounts receivable at October 31, 2012 and 2011. In addition, the Organization's write-offs increased approximately \$133,000 from approximately \$1,081,000 for the year ended October 31, 2011, to approximately \$1,214,000 for the year ended October 31, 2012.

Supplies and Inventories

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

Community Health Association of Spokane, Inc.

Notes to Financial Statements

October 31, 2012 and 2011

Property and Equipment

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

Certain property and equipment have been purchased with grant funds. Such items may have a reversionary interest by the grantor if not used to further the grants objectives or held for a specific length of time.

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.

The Organization capitalizes interest costs as a component of construction in progress, based on the weighted-average rates paid for long-term borrowing. The total interest incurred was:

	<u>2012</u>	<u>2011</u>
Interest costs capitalized	\$ 171,826	\$ 19,550
Interest costs charged to expense	<u>54,936</u>	<u>267,199</u>
	<u>\$ 226,762</u>	<u>\$ 286,749</u>

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.

Deferred Financing Costs

Deferred financing costs represent costs incurred in connection with the issuance of long-term debt. Such costs are being amortized over the term of the respective debt using the straight-line method.

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.

Community Health Association of Spokane, Inc.

Notes to Financial Statements

October 31, 2012 and 2011

Premium Revenue and Cost Pool Savings

The Organization has agreements with Community Health Plan of Washington (CHPW) and Molina Healthcare, Inc. to provide medical services to subscribing participants. Under these plans, the Organization receives monthly capitation payments based on the number of participants, regardless of the services actually performed by the Organization. The Organization also receives monthly capitation payments for Medicaid eligible participants from the state Medicaid program. In addition, these plans make fee-for-service payments to the Organization for certain covered services based upon discounted fee schedules.

CHPW distributes any cost pool savings or charges additional costs to its member organizations based on the annual experience of the Organization and other member organizations. Cost pool savings or additional costs are estimated by the Organization using historical information and existing economic conditions, but are generally not distributed until the August following the fiscal year end with final settlements expected the next May.

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.

Income Taxes

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

Electronic Health Records Incentive Program

The Electronic Health Records Incentive Program, enacted as part of the *American Recovery and Reinvestment Act of 2009*, provides for one-time incentive payments under both the Medicare and Medicaid programs to eligible federally qualified health centers that demonstrate meaningful use of certified electronic health records technology (EHR). Payments under the Medicare program are generally made for up to four years based on a statutory formula. Payments under the Medicaid program are generally made for up to six years based upon a statutory formula, as determined by the State, which is approved by the Centers for Medicare and Medicaid Services. Payment under

Community Health Association of Spokane, Inc.

Notes to Financial Statements

October 31, 2012 and 2011

both programs are contingent on the Organization continuing to meet escalating meaningful use criteria and any other specific requirements that are applicable for the reporting period. The final amount for any payment year is determined based upon an audit by the State, fiscal intermediary or Medicare Administrative Contractor. Events could occur that would cause the final amounts to differ materially from the initial payments under the program.

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

The Organization has completed certain first and second year requirements under the Medicaid program and has recorded revenue of \$654,500 and \$1,041,250 in the years ended October 31, 2012 and 2011, respectively.

Excess of Revenues Over Expenses

The statements of operations include excess of revenues over expenses. Changes in unrestricted net assets which are excluded from excess of revenues over expenses, consistent with industry practice, include unrealized gains and losses on investments other than trading securities and contributions or 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).

Self-Insurance

The Organization has elected to self-insure certain costs related to employee health and accident benefit programs. Costs resulting from noninsured losses are charged to income when incurred. The Organization has purchased insurance that limits its exposure for individual claims.

Reclassifications

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 change in net assets.

Subsequent Events

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

Community Health Association of Spokane, Inc.

Notes to Financial Statements

October 31, 2012 and 2011

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 for residents of the Spokane community. Terms of the grant generally provide for funding of the Organization's operations based on an approved budget. During the years ended October 31, 2012 and 2011, the Organization recognized \$3,597,012 and \$3,129,792 in CHC grant funds, respectively. Funding for the year ending October 31, 2013, is approved at \$3,440,809.

In response to the current economic conditions, the federal government passed legislation appropriating grant dollars to community health centers under the American Recovery and Reinvestment Act (ARRA). The Organization has been awarded \$452,879 under the Increased Demand for Services (IDS) grant for the period of March 27, 2009, to March 26, 2011, to assist in meeting the needs of the communities served; \$1,203,715 under the Capital Improvement Program (CIP) grant for the period of June 29, 2009, to June 28, 2011, for facility expansion; and, \$1,300,000 under the New Access Point (NAP) grant for the period of March 1, 2009, through February 28, 2011, to assist with the opening of a new site in Lewiston, Idaho. Grant revenue is recognized as qualifying expenditures are incurred over the grant periods. During the year ended October 31, 2011, the Organization recognized \$76,313 of IDS grant revenue, \$577,139 of CIP grant revenue, and \$216,666 of NAP grant revenue. No such revenue was recognized during the year ended October 31, 2012.

In addition to the aforementioned 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 Medicare and Medicaid 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:

Community Health Association of Spokane, Inc.

Notes to Financial Statements

October 31, 2012 and 2011

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.

Medicaid. Covered FQHC services rendered to Medicaid program beneficiaries are paid based on a prospective reimbursement methodology. The Organization is reimbursed a set encounter rate for all services provided under the plan including supplemental payments for eligible encounters paid under managed care insurance arrangements. Services not covered under the FQHC benefit are paid based on established fee schedules.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, no estimate of this settlement is recorded in the financial statements. It is reasonably possible that recorded estimates will change materially in the near term.

The Organization receives enhancement funding from the State of Washington for certain Medicaid services provided to certain Medicaid eligible patients. The amounts funded under this program are required to be reconciled against the services provided. Due to rebasing of the Organization's Medicaid encounter rate during 2010, and issues surrounding the application of this rebased rate to the enhancement reconciliation calculation, the Organization is unable to determine the amount of enhancement, if any, that may be receivable or payable, pending resolution of the underlying issues. As a result, no estimate of this settlement is recorded in the financial statements. It is reasonably possible that recorded estimates will change materially in the near term.

Patient service revenue, net of contractual allowances and discounts (but before the provision for uncollectible accounts), recognized in the years ended October 31, 2012 and 2011, was approximately:

	2012	2011
Medicare	\$ 1,636,200	\$ 1,589,015
Medicaid	8,058,663	7,419,942
Other third-party payers	13,572,176	11,100,562
Self-pay	2,817,295	3,015,793
Total	<u>\$ 26,084,334</u>	<u>\$ 23,125,312</u>

Community Health Association of Spokane, Inc.
Notes to Financial Statements
October 31, 2012 and 2011

Note 4: Concentrations 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 net receivables from patients and third-party payers at October 31, 2012 and 2011, was:

	2012	2011
Medicare	18%	17%
Medicaid	30%	42%
Other	52%	41%
	100%	100%

Note 5: Medical Malpractice Claims

The Organization purchases medical malpractice insurance under a claims-made policy on a fixed premium basis. Under such a policy, only claims made and reported to the insurer during the policy term, regardless of when the incidents giving rise to the claims occurred, are covered. The Organization also purchases excess umbrella liability coverage, which provides additional coverage above the basic policy limits up to the amount specified in the umbrella policy.

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

Based upon the Organization's claims experience, no accrual has been made for medical malpractice costs for the years ended October 31, 2012 and 2011. However, because of the risk of providing health care services, it is possible that an event has occurred which will be the basis of a future material claim.

Community Health Association of Spokane, Inc.

Notes to Financial Statements

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Note 6: Line of Credit

The Organization has an unsecured \$900,000 stand-alone revolving line of credit. The line of credit bears interest at a rate of 0.50% above the bank’s prime interest rate, which was 3.75% as of October 31, 2012 and 2011. The line of credit matures in June 2013. No amounts were outstanding as of October 31, 2012 and 2011.

Note 7: Long-Term Debt

	2012	2011
Bond payable (A)	\$ 1,002,199	\$ 1,056,746
Bond payable (B)	3,480,138	3,669,552
Note payable, bank (C)	24,049	33,916
Note payable, bank (D)	82,913	86,869
Capital lease obligations (E)	298,550	110,000
	4,887,849	4,957,083
Less current maturities	410,966	303,921
	\$ 4,476,883	\$ 4,653,162

(A) Series 2010A Revenue Bond (the “2010A Bond”) payable to Washington Health Care Facilities Authority (the “Authority”), due December 16, 2020; payable \$8,410 monthly, including interest of 4.42%; secured by real property.

The 2010A Bond, in the amount of \$1,100,503, was issued through the Authority, a quasigovernmental agency, in December 2010. As a condition of this issuance, the Organization has agreed to certain covenants for the protection of the bond owners, including covenants to maintain its status as a nonprofit organization, to use the facility in furtherance of its lawful corporate purpose, to pay the Authority annual fees not exceeding one-tenth of one percent (0.1%) of the principal amount of the 2010A Bond then outstanding, to pass on savings to their patients, and to limit its ability to incur additional indebtedness.

The proceeds of the 2010A Bond were used to finance construction and equipping of a health care facility to be owned and operated by the Organization and to retire other existing debt.

The 2010A Bond is subject to redemption at the option of the Organization, in whole or in part, at a price equal to 100% of the current outstanding principal amount of the 2010A Bond.

Community Health Association of Spokane, Inc.

Notes to Financial Statements

October 31, 2012 and 2011

The bond indenture requires the Organization to comply with certain restrictive covenants including current ratio, debt to tangible net worth ratio and fixed charge coverage ratio. The measurement dates for these requirements is October 31.

- (B) Series 2010B Revenue Bond (the “2010B Bond”) payable to the Authority, due December 16, 2020; payable \$29,204 monthly, including interest of 4.42%; secured by a deed of trust.

The 2010B Bond, in the amount of \$3,821,497, was issued through the Authority, a quasigovernmental agency, in December 2010. As a condition of this issuance, the Organization has agreed to certain covenants for the protection of the bond owners, including covenants to maintain its status as a nonprofit organization, to use the facility in furtherance of its lawful corporate purpose, to pay the Authority annual fees not exceeding one-tenth of one percent (0.1%) of the principal amount of the 2010B Bond then outstanding, to pass on savings to their patients and to limit its ability to incur additional indebtedness.

The proceeds of the 2010B Bond were used to finance construction and equipping of a health care facility to be owned and operated by the Organization and to retire other existing debt.

The 2010B Bond is subject to redemption at the option of the Organization, in whole or in part, at a price equal to 100% of the current outstanding principal amount of the 2010B Bond.

The bond indenture requires the Organization to comply with certain restrictive covenants including current ratio, debt to tangible net worth ratio and fixed charge coverage ratio. The measurement dates for these requirements is October 31.

- (C) Equipment loan payable \$947 monthly, including interest at 4.99%, through January 2015, collateralized by the equipment.
- (D) Land loan payable \$767 monthly, including interest at 6.07%, through December 16, 2020, collateralized by a deed of trust.
- (E) Capital lease obligations for office and pharmaceutical equipment, including interest at various imputed interest rates between 1% and 9% due at various dates through May 2015; collateralized by equipment. The following equipment is under capital leases:

	<u>2012</u>	<u>2011</u>
Equipment	\$ 401,748	\$ 217,346
Less accumulated depreciation	<u>212,257</u>	<u>145,749</u>
	<u>\$ 189,491</u>	<u>\$ 71,597</u>

Community Health Association of Spokane, Inc.
Notes to Financial Statements
October 31, 2012 and 2011

Aggregate annual maturities of long-term debt and payments on capital lease obligations at October 31, 2012, are:

	Long-Term Debt (Excluding Capital Lease Obligation)	Capital Lease Obligation
	<u> </u>	<u> </u>
2013	\$ 270,310	\$ 146,249
2014	282,814	105,569
2015	287,158	53,672
2016	297,041	-
2017	311,152	-
Thereafter	<u>3,140,824</u>	<u>-</u>
	<u>\$ 4,589,299</u>	305,490
Less amount representing interest		<u>6,940</u>
Present value of future minimum lease payments		298,550
Less current maturities		<u>140,656</u>
Noncurrent portion		<u>\$ 157,894</u>

Note 8: Functional Expenses

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

	2012	2011
	<u> </u>	<u> </u>
Health care services	\$ 23,659,399	\$ 23,653,044
General and administrative	<u>12,708,810</u>	<u>10,131,402</u>
	<u>\$ 36,368,209</u>	<u>\$ 33,784,446</u>

Community Health Association of Spokane, Inc.
Notes to Financial Statements
October 31, 2012 and 2011

Note 9: Operating Leases

The Organization leases two medical clinic sites, one administrative site and various equipment under noncancelable lease agreements that expire in various years through 2019.

Future minimum lease payments at October 31, 2012, were:

2013	\$ 589,647
2014	578,983
2015	537,707
2016	288,444
2017	241,852
Thereafter	<u>416,416</u>
Future minimum lease payments	<u>\$ 2,653,049</u>

Note 10: Pension Plan

The Organization has a defined contribution pension plan covering substantially all employees. Eligible employee contributions are matched up to a rate of 4% of employees' salaries. Pension expense was \$442,966 and \$384,088 for the years ended October 31, 2012 and 2011, respectively.

Note 11: Significant Estimates and Concentrations

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

Grant Revenues

Concentration of revenues related to grant awards and other support is described in *Note 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 professional liability claims are described in *Note 5*.

Community Health Association of Spokane, Inc.

Notes to Financial Statements

October 31, 2012 and 2011

Self-Insurance

Under the Organization's insurance programs, coverage is obtained for catastrophic exposures as well as those risks required to be insured by law or contract. The Organization retains a significant portion of certain expected losses related primarily to employee health, dental and vision and unemployment coverage.

Provision for losses expected under these programs are recorded based upon the Organization's estimates of the aggregated liability for claims incurred and totaled \$275,000 and \$190,000 at October 31, 2012 and 2011, respectively. The amount of actual losses incurred could differ materially from these estimates. The Organization does maintain stop-loss commercial coverage.

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 ultimate loss to differ materially in the near term.

Regulatory and Reimbursement Environment

The upcoming implementation of the *Affordable Care Act*, including the health insurance exchanges and the decision by the state regarding Medicaid expansion, will directly impact community health centers' net revenues. Further, the effect of economic conditions on federal and state budgets could adversely impact the grant revenues available to community health centers and the programs they administer. Each of these factors could have an adverse impact on the Center's future operating results.

Note 12: Construction in Progress

The Organization is expanding and renovating one of its clinics. The expansion is expected to cost approximately \$1,500,000 and includes construction of an approximately 7,000 square foot addition. The renovation project is expected to cost approximately \$3,600,000 and will entail completing the interior of the addition and the renovation of the existing physical space. The expansion project was financed with a combination of the Organization's cash and bond financing. The projects are anticipated to be completed by July 1, 2013. Project costs of approximately \$2,947,000 have been incurred through October 31, 2012, of which \$465,000 are included in construction in progress on the balance sheet. The remaining \$2,482,000 was placed into service during 2012.

Supplementary Information

Community Health Association of Spokane, Inc.
Schedule of Expenditures of Federal Awards
Year Ended October 31, 2012

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 H80CS 00319-10-07	\$ 2,049,872
Affordable Care Act (ACA) Grants Under the Health Center Program	U.S. Department of Health and Human Services	93.527	6 H80CS 00319-10-07	<u>1,547,140</u>
Total Health Centers Cluster				3,597,012
Grants to Provide Outpatient Early Intervention Services with Respect to HIV Disease	U.S. Department of Health and Human Services	93.918	6 H76HA 00749-11-01	<u>401,408</u>
				<u><u>\$ 3,998,420</u></u>

Notes to Schedule

1. This schedule includes the federal awards activity of Community Health Association of Spokane, 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. Community Health Association of Spokane, Inc. did not provide a federal award to a subrecipient during the year ended October 31, 2012.

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

Board of Directors
Community Health Association of Spokane, Inc.
Spokane, Washington

We have audited the financial statements of Community Health Association of Spokane, Inc. (the "Organization") as of and for the year ended October 31, 2012, and have issued our report thereon dated May 14, 2013, which contained an explanatory paragraph regarding a change in accounting principle. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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.

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

Board of Directors
Community Health Association of Spokane, 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*.

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

BKD, LLP

May 14, 2013

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

Board of Directors
Community Health Association of Spokane, Inc.
Spokane, Washington

Compliance

We have audited the compliance of Community Health Association of Spokane, Inc. (the "Organization") with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that could have a direct and material effect on each of its major federal programs for the year ended October 31, 2012. 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. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Organization's management. Our responsibility is to express an opinion on the compliance of Community Health Association of Spokane, Inc. based on our audit.

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

In our opinion, Community Health Association of Spokane, Inc. complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended October 31, 2012.

Board of Directors
Community Health Association of Spokane, Inc.

Internal Control Over Compliance

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

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

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

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

BKD, LLP

May 14, 2013

Community Health Association of Spokane, Inc.
Schedule of Findings and Questioned Costs
Year Ended October 31, 2012

8. The threshold used to distinguish between Type A and Type B programs as those terms are defined in OMB Circular A-133 was \$300,000.

9. The Organization qualified as a low-risk auditee as that term is defined in OMB Circular A-133?

Yes

No

Community Health Association of Spokane, Inc.
Schedule of Findings and Questioned Costs
Year Ended October 31, 2012

Findings Required to be Reported by *Government Auditing Standards*

Reference Number	Finding	Questioned Costs
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No matters are reportable.

Findings Required to be Reported by OMB Circular A-133

Reference Number	Finding	Questioned Costs
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No matters are reportable.

Community Health Association of Spokane, Inc.
Summary Schedule of Prior Audit Findings
Year Ended October 31, 2012

Reference Number	Finding	Status
11-1	<p style="text-align: center;">CFDA No. 93.224, Consolidated Health Centers U.S. Department of Health and Human Services Award No. 6 H80CS00319-09-07, Program Year 2011</p> <p>Criteria or Specific Requirement – Eligibility</p> <p>Condition – Patients were given a sliding fee adjustment without having proper supporting income documentation in accordance with the Organization’s policy.</p> <p>Context – Out of an undetermined number of patients who received a sliding fee adjustment, a sample of 40 patients were tested. One patient did not have a signed sliding fee application to support eligibility. One patient had a signed sliding fee application; however, the income documentation did not support the patient receiving a sliding fee adjustment.</p> <p>We also noted eight patients who had signed sliding fee applications supporting eligibility; however, these patients did not claim any income on their application. It was the Organization’s sliding fee discount policy prior to July 1, 2011 that a patient is allowed to receive a sliding fee discount on their first visit to the clinic; however, specific documentation of income status was required on subsequent visits in order to be eligible for a sliding fee discount. These eight patients were given sliding fee discounts without the further income documentation that was required under the Organization’s sliding fee policy in effect at that time.</p> <p>Effect – Appropriate documentation was not maintained for adjustments given.</p> <p>Cause – Organization personnel were not appropriately following sliding fee policy.</p>	Resolved

Community Health Association of Spokane, Inc.
Summary Schedule of Prior Audit Findings
Year Ended October 31, 2012

Reference Number	Finding	Status
10-2	<p style="text-align: center;">CFDA No. 93.224, Consolidated Health Centers U.S. Department of Health and Human Services Award No. 6 H80CS00319-08-07, Program Year 2010</p> <p>Criteria or Specific Requirement – Eligibility</p> <p>Condition – Patients were given a sliding fee adjustment without having proper supporting income documentation in accordance with the Organization’s policy.</p> <p>Context – Out of an undetermined number of patients who received a sliding fee adjustment, a sample of 40 patients were tested. Two patients did not have any documentation to support eligibility. Two patients had signed sliding fee applications supporting eligibility; however, these patients did not have proper documentation to support the income included on the application.</p> <p>We also noted eleven patients who had signed sliding fee applications supporting eligibility; however, these patients did not claim any income on their application. It is the Organization’s sliding fee discount policy that a patient is allowed to receive a sliding fee discount on their first visit to the clinic; however, documentation of income status is required on subsequent visits in order to be eligible for a sliding fee discount. These eleven patients were given sliding fee discounts without further income documentation even though it was not their first visit.</p> <p>Effect – Appropriate documentation was not maintained for adjustments given.</p> <p>Cause – Organization personnel were not appropriately following sliding fee policy.</p>	Resolved